CLERK'S COPY.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932

No. 475

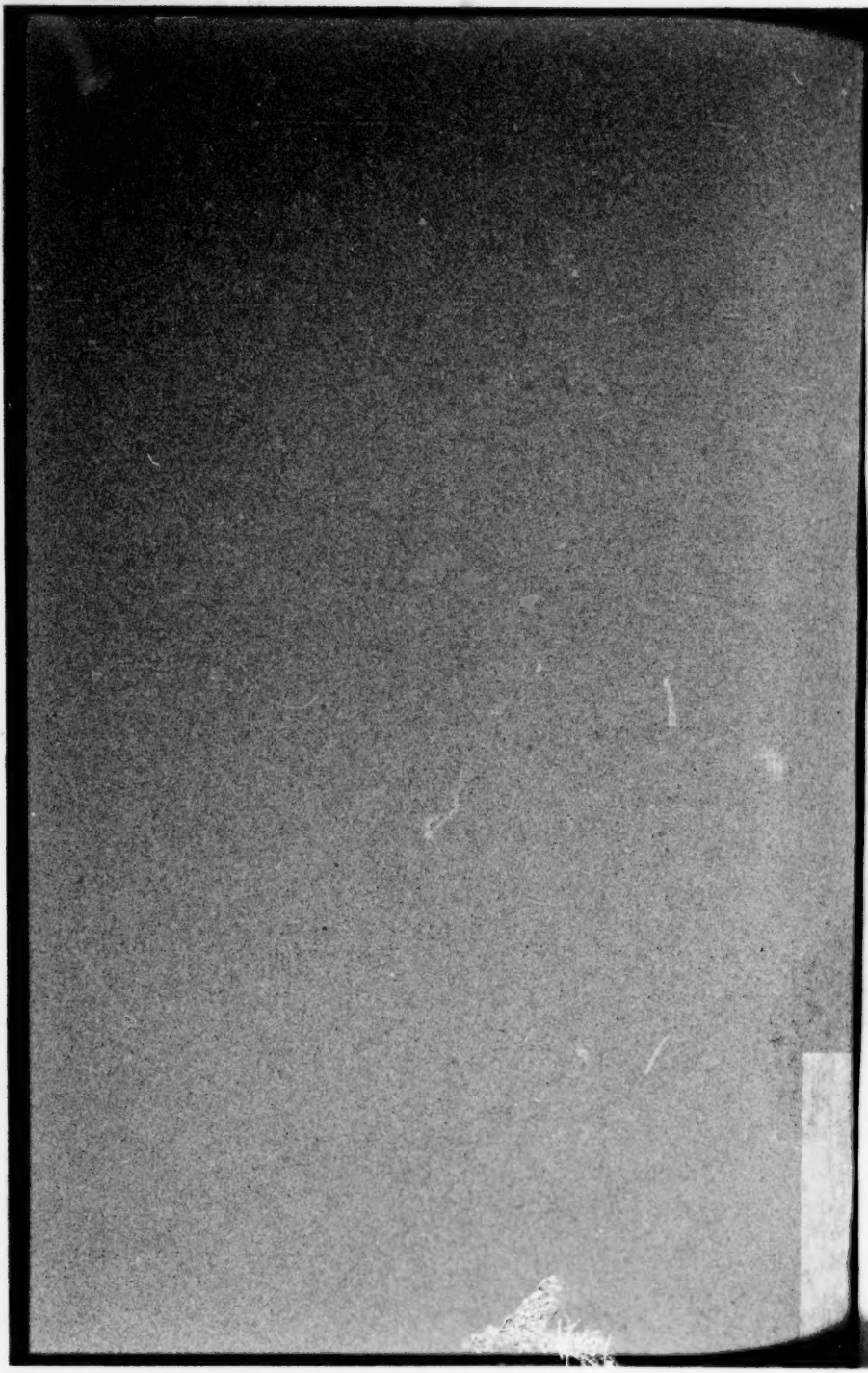
DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

S. & L. BUILDING CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 25, 1932
CERTIORARI GRANTED DECEMBER 5, 1932



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1 Before United States Board of Tax Appeals

Docket No. 36950

S. AND L. BUILDING CORP., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket entries

Appearances: For petitioner, Geo. W. Perper, Esq.; for respondent: F. R. Shearer, Esq., and E. L. Corbin, Esq.

1928

Apr. 2—Petition received and filed. Taxpayer notified. Fee paid.
Apr. 3—Copy of petition served on general counsel.
June 2—Motion for extension to 9/2/28 to answer filed by general counsel. Granted.
Sept. 1—Motion for extension to 12/2/28 to answer filed by general counsel. Granted.
Dec. 3—Motion for extension to 4/2/29 to answer filed by general counsel. Granted.

1929

Apr. 2—Answer filed by general counsel.
Apr. 5—Copy of answer served on taxpayer; assigned to general calendar.
Nov. 25—Hearing set 2/3/30.

2 1930

Feb. 3—Hearing held before Mr. Black on merits; no briefs.
Feb. 6—Transcript of hearing 2/3/30 filed.
Feb. 14—Amended petition filed.
Feb. 20—Answer to amended petition filed by general counsel.
Apr. 30—Findings of fact and opinion rendered, Eugene Black, division 15. Judgment will be entered under rule 50.
June 17—Notice of settlement filed by general counsel.
June 20—Hearing set July 9, 1930, under rule 50.
July 3—Motion to continue hearing to July 30, 1930, filed by general counsel.
July 9—Hearing held before Mr. Phillips under rule 50. On motion of respondent continued to July 30.
July 9—Order of continuance to day calendar of July 30, 1930, entered.
July 17—Notice of objections to proposed redetermination filed by taxpayer. Copy served 7/18/30.
July 30—Hearing held before Mr. Black on contested settlement under rule 50.
Aug. 20—Transcript of hearing July 30, 1930, filed.
Sept. 16—Order of redetermination entered, Eugene Black, division 15.

1931

Feb. 18—Petition for review by U. S. Circuit Court of Appeals (2) with assignments of error filed by taxpayer.

3 Feb. 18—Præcipe filed.

Feb. 18—Proof of service filed—petition and præcipe.

Feb. 27—Motion for extension to March 7, 1931, to file objections to præcipe filed by general counsel. Granted.

Now, March 7, 1931, the foregoing docket entries certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed April 2, 1928

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:FAR:A-6-MN-60D)

4 dated February 4, 1928, and as a basis of its proceedings alleges as follows:

1. The petitioner is a New York corporation with its principal office at 2382 Grand Concourse, New York, N. Y.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the taxpayer on February 4, 1928.

3. The amount of the deficiency is $34,342.08 for income taxes for the calendar years 1924 and 1925 and the amount thereof in controversy is seven thousand nine hundred and eighty-six and 89/100 dollars ($7,986.89).

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The failure of the commissioner to allow the full amount of mortgage expense and fees incurred in connection with 82nd Street and Broadway and 83rd Street and Broadway properties.

(b) The commissioner has in error allowed as a deduction the mortgage fees and expense in connection with 82nd Street and Broadway and 83rd Street and Broadway properties in the years 1924 and 1925 instead of in the years 1923 and 1924.

(c) That the statutory net loss for the year 1923, applied as a deduction by the commissioner for the year 1924 has been incorrectly computed.

5 (d) The commissioner failed to eliminate from the 1924 income an item representing adjustments of cost of premises 2608 Creston Avenue sold by petitioner in the year 1922.

(e) The commissioner incorrectly computed the taxable profit on Broadway and 83rd Street property sold in the year 1925 by his failure to properly apply the installment sales provision of the law.

5. The facts upon which the taxpayer relies as the basis of this proceeding are as follows:

(a) The total mortgage expenses and fees re 82nd Street and Broadway property amounted to $97,627.50. (See revenue agent's revised report dated December 29, 1927, page seven (7) thereof.) The commissioner, in error, took as a deduction (see page 5, Exhibit A, attached) $91,008.75 instead of the total fees incurred of $97,627.50.

(b) The total mortgage expenses and fees re 83rd Street and Broadway property amounted to $179,500.00. (See revenue agent's revised report dated December 29, 1927, page seven (7) thereof.) The commissioner, in error, took as a deduction (see page seven, Exhibit A, hereto attached) $161,550.00 instead of the total fees incurred of $179,500.00.

(c) The mortgage fees and expenses of $97,627.50 re 82nd Street and Broadway property were incurred in the year 1923 and the
6 mortgage fees and expenses of $179,500.00 re 83rd Street and Broadway property were incurred in the year 1924. (See revenue agent's revised report dated December 29, 1927, page seven (7) thereof.) The commissioner, therefore, was in error in deducting these items for the years 1924 and 1925, respectively. (See pages 5 and 7 of report dated February 4, 1928, Exhibit A, hereto attached.)

(d) The mortgage fees and expenses incurred in the year 1923 of $97,627.50 re 82nd Street and Broadway property should have been deducted by the commissioner in said year 1923. (See item 5 (c) above.) The statutory net loss for 1923 of $2,525.26 (see page 5, Exhibit A, hereto attached) should be increased by the above amount of $97,627.50, resulting in a correct statutory net loss of $100,152.76, which amount should be applied in accordance with section 206 of the revenue act of 1924.

(e) Petitioner filed, on March 5th, 1928, a claim for refund for the calendar year 1923 showing thereon that the correct statutory net loss for said year 1923 amounts to $100,152.76, which amount should be applied in accordance with section 206 of the revenue act of 1924.

(f) There has been included as income on page one (1) of the schedules attached to the 1924 corporation income-tax return filed by the petitioner, an item of $3,336.81 with the following explanation: "Premises 2608 Creston Avenue, sundry allowances received from
7 contractors after sale of premises."

(g) The property of 2608 Creston Avenue consisted of land and building which was constructed by petitioner. Said property was sold in the year 1922.

(h) The amount of $3,336.81 represents the aggregate reductions of cost of the property 2608 Creston Avenue, due to returns of furniture and equipment and sundry allowances and adjustments of construction contracts.

(i) The adjustments of $3,336.81 above referred to, reducing cost of premises 2608 Creston Avenue, were not made on the books of the company until the year 1924.

(j) The commissioner failed to eliminate from 1924 income the aggregate adjustments of $3,336.81 on property 2608 Creston Ave. sold in 1922. On the other hand, the commissioner eliminated a deduction taken by petitioner on page three (3) of the schedules attached to the 1923 income-tax return filed by him an item of $230.11. The explanation on the tax return for this item of $230.11 is as follows: "Premises 2608 Creston Avenue (& 193rd St.); sundry adjustments in 1923, premises sold in 1922.

(k) The premises located at 83rd Street and Broadway, New York City, was sold by petitioner April 15th, 1925, for $2,165,000.00.

(l) This property at 83rd Street and Broadway was sold subject to an existing first mortgage of $1,100,000.00 and existing second mortgage of $500,000.00.

8 (m) The petitioner received from the purchaser during the taxable year 1925, on the sale of the 83rd Street and Broadway property, $265,000.00 in a purchase-money mortgage, on account of which $2,000.00 of cash installments were paid during the year 1925. The petitioner also received $300,000.00 in cash from purchaser on sale of said premises, making the total cash received from the purchaser during the year 1925, $302,000.00.

(n) The gross profit on sale of 83rd Street and Broadway, after deducting from the purchase price the net cost of $1,522,033.00 amounts to $642,967.00.

(o) The total contract price on sale of 83rd Street and Broadway amounts to $565,000.00.

(p) The initial payment on sale of 83rd Street and Broadway amounts to $302,000.00.

(q) The gross profit of $642,967.00 to be realized on sale of 83rd Street and Broadway is 113.8% of the total contract price of $565,000.00.

(r) The correct method of reporting the taxable profit on installment basis for the year on sale of 83rd Street and Broadway property is 113.8% of the initial payment of $302,000.00 and the profit is $343,676.00.

(s) The petitioner included in his 1925 income-tax return filed profit of $2,234.56 on sale of above property. (See revenue agent's report dated June 6, 1927, Exhibit P.)

9 (t) The correct increase in taxable profit for the year 1925 on the sale of 83rd Street and Broadway is $341,441.44, representing the difference between $343,676.00 and $2,234.56, as shown above, instead of $377,732.44 as shown on page six (6) of commissioner's letter dated February 4, 1928, Exhibit A, hereto attached.

6. Wherefore, the petitioner prays that this board may hear the proceedings and determine that the full amount of mortgage fees and expenses in re 82nd Street and 83rd Street and Broadway properties be allowed in the years 1923 and 1924; that the correct statutory

net loss for the year 1923 be applied to the subsequent years according to law; that adjustments of cost of premises 2608 Creston Avenue be eliminated from the 1924 income; that the taxable profit on 83rd Street and Broadway property be computed on the installment-sales basis of 113.8% of the initial payment of $302,000.00; that there is no deficiency for the year 1924; that the statutory net loss for the year 1924 be applied to the year 1925; that the deficiency for the year 1925 is $26,355.19.

GEORGE W. PERPER,
Counsel for Petitioner,
11 West 42nd Street, Manhattan Borough, New York City.

10 [*Duly sworn to by Sam Minskoff; jurat omitted in printing.*]

11 *Exhibit A to petition*

[SEAL.]

Address reply to Commissioner of Internal Revenue and refer to IT:FAR:A-6-MN-60D.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Feb. 4, 1928.

S. AND L. BUILDING CORPORATION,
2382 Grand Concourse, New York, New York.

SIR: In accordance with section 274 of the revenue act of 1926 you are advised that the determination of your tax liability for the years 1923, 1924, and 1925 discloses a deficiency of $34,342.08 for the years 1924 and 1925 and an overassessment of $5,255.31 for the year 1923, as shown in the attached statement.

The section of the law above mentioned allows you an appeal to the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter. However, if you acquiesce in this determination, you are requested to execute the enclosed

12 Form A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,

D. H. BLAIR, *Commissioner.*
By C. B. ALLEN, *Deputy Commissioner.*

Enclosures: Statement; Form A; Form 882.

STATEMENT

IT:FAR:A-6-MN-60D.

In re S. and L. Building Corporation, 2382 Grand Concourse, New York, New York.

Year	Deficiency in tax	Overassessment
1923		$5,255.31
1924	$394.69	
1925	33,947.39	
Total	$34,342.08	$5,255.31

Net deficiency, $29,086.77

Reference is made to your protest dated October 27, 1927, against the determination of your tax liability as set forth in bureau letter dated October 21, 1927, covering the years 1923 to 1925, inclusive.

13 You are advised that after due consideration of your protest, together with the information submitted during the conference held November 16, 1927, and the subsequent information submitted in your brief dated December 15, 1927, your tax liability has been redetermined in accordance with your contentions wherein the fees for raising mortgage loans were allowed as a deduction in the year in which incurred.

The result of the determination, in accordance with the foregoing conclusions, is as follows:

1923

Net income as reported		$42,042.53
Additions:		
1. 1922 expenses	$230.11	
2. Profit on sale of real estate	14,000.00	
		14,230.11
		$56,272.64
Deductions:		
3. Excessive profit on sale of real estate	$5,987.27	
4. Post sale expenses	32.25	
5. Additional depreciation, 82nd Street and Broadway	8,418.74	
6. Increase depreciation	10,054.84	
7. Expenses paid in 1926	1,000.00	
8. Excess of fees incurred and paid	33,815.41	
		59,308.51
Net income as adjusted (loss)		($3,035.87)

14 EXPLANATION OF ADJUSTMENTS

(1) This represents 1922 expenses of Post sale items paid in 1923 in connection with property which was sold in 1922.

(2) Since the profit on sale of northwest corner of Kingsbridge Road and Creston Avenue is a completed transaction, which sale was consummated during the year 1923, the amount of $6,000.00 received during the year 1924 and the amount of $8,000.00 received during the year 1925 have been considered income during the current year and the income for the years 1924 and 1925 has been reduced by $6,000.00 and $8,000.00, respectively.

(3) The property of 2055-2065 Creston Avenue having been sold and treated as a completed transaction during the year 1923, the bills for furnishings and equipment amounting to $5,987.27, which were received and paid during the year 1924, have been allowed as a deduction for the current year.

(4) Post sale expenses of $32.25 represents items paid in 1924 in connection with the property at northwest corner of Kingsbridge Road and Creston Avenue, which was sold in 1923.

(5) In accordance with your claim for additional depreciation on property 82nd Street and Broadway, your contention has been allowed and depreciation increased in the amount of $8,418.74 in accordance with Schedule 1–A, revised, of the revenue agent's report.

15 (6) Increased depreciation has been allowed at the rate of 3%, as claimed in your brief. The increase of $10,054.84, as set forth by the agent in his report under item D, Schedule 1–A, Revised, has been reviewed and approved.

(7) The item of $1,000.00 as expenses paid during the year 1926, account of northwest corner Kingsbridge Road and Creston Avenue, has been allowed.

(8) This item represents the excess of the mortgage expense fees incurred and paid over the amount deducted on the return. This is allowed in accordance with your protest and computed as follows:

Fees incurred (in accordance with your schedule attached to your letter dated December 15, 1927)		$65,849.54
Less:		
Deductions taken on return	$25,415.38	
82nd Street and Broadway	6,618.75	32,034.13
Difference		$33,815.41
Computation of tax:		
Net income (loss)		($3,035.87)
Tax liability		None.
Original assessment, account #404739		5,255.31
Overassessment		$5,255.31

16

1924

Net income as reported (loss)		($67,574.31)
Additions:		
1. Additional cost of 2055–2065 Creston Avenue	$5,987.27	
2. Profit on sale of premises 82nd Street and Broadway	184,363.25	
3. Expenses, northwest corner Kingsbridge Road and Creston Avenue	32.25	190,382.77
Total		$122,808.46
Deductions:		
4. Purchase-money mortgage receipts	$6,000.00	
5. Commissions, etc	22,217.00	
6. Depreciation, 82nd Street and Broadway	2,806.25	
7. Depreciation, 83rd Street and Broadway	8,250.10	
8. Increase depreciation	11,186.55	
9. Excess of fees incurred and paid	64,665.75	115,125.65
Net income as adjusted		$7,682.81

17

EXPLANATION OF ADJUSTMENTS FOR 1924

(1) See explanation of item (3) for the year 1923.

(2) The profit on the sale of the premises, 82nd Street and Broadway, has been approved as computed by the agent, the details of which are shown in Exhibit O, revised and amended.

(3) See explanation of item (4) for the year 1923.

(4) See explanation of item (2) for the year 1923.

(5) Commissions, etc., have been increased by $22,217.00 to allow as a deduction the expenses of sale of property, 82nd Street and Broadway, which expenses were deferred until 1925.

(6) Depreciation on the property at 82nd Street and Broadway has been allowed in the amount of $2,806.25 up to February 1, 1924, date of sale of property.

(7) Depreciation on the property at 82nd Street and Broadway has been increased by $8,250.10 to allow depreciation from October 1, 1924, to the end of the year in accordance with details as set out by the agent under Schedule 3–A, revised, item D.

(8) Depreciation has been increased from 2% to 3% in
18 accordance with the computation as set forth in the agent's report under item E. Schedule 3–A, revised.

(9) See explanation of item (8) for the year 1923.

Fees incurred:		
1325 Grand Concourse		$10,525.00
82nd Street and Broadway		91,008.75
Total		$101,533.75
Deductions taken:		
2665 Grand Concourse	$11,838.50	
180th Street and Boston Road	3,375.00	
2382 Grand Concourse	2,652.00	
1325 Grand Concourse	1,052.50	
Broadway, 82nd and 83rd Streets	17,950.00	36,868.00
Difference		$64,665.75
Computation of tax:		
Net income		$7,682.81
Less:		
Net loss (section 206, revenue act of 1924)	$2,525.26	
Exemption	2,000.00	4,525.26
Balance taxable at 12½%		$3,157.55
Tax liability		394.69
Previously assessed		None.
Deficiency		$394.69

19 Computation of statutory loss for 1923:

Net loss	$3,035.87
Nontaxable interest	510.61
Statutory loss	$2,525.26

1925

Net income as reported (loss)		($28,040.46)
Additions:		
1. Profit on real estate, 83rd Street and Broadway	$377,732.44	
2. Profit on real estate, 82nd Street and Broadway	20,252.02	
3. Commissions	22,217.00	
4. Profit on real estate, 180th Street and Boston Road	3,618.92	
5. Net loss for 1924	67,574.31	$491,394.69
Total		$463,354.23

Deductions:		
6. Purchase money mortgage receipts	$8,000.00	
7. Commissions	21,000.00	
8. Post sale expenses	4,960.59	
9. Depreciation, 83rd Street and Broadway	9,625.12	
10. Depreciation, 2665 Grand Concourse	12,150.86	
11. Excess of fees incurred and paid	146,483.92	202,220.49
Net income as adjusted		$261,133.74

20

EXPLANATION OF ADJUSTMENTS

(1) Profit on sale of property at 83rd Street and Broadway has been approved as computed by the agent under Exhibit O, revised and amended.

(2) The profit on the sale of property, 82nd Street and Broadway, has been approved as computed by the agent under Exhibit P, revised and amended.

(3) Commissions have been decreased by $22,217.00, representing amount paid on the sale of property at 82nd Street and Broadway and which has been allowed as a deduction during the year 1924.

(4) The profit on sale of property at 180th Street and Boston Road has been increased by $3,618.92 on account of additional depreciation allowed during the years 1923 and 1924.

(5) Since there is a gain disclosed for the year 1924, the net loss as deducted has been disallowed.

(6) See explanation of item (2) for the year 1923.

(7) Commissions have been increased $21,000.00 to allow as an expense the amount paid on the sale of property of 83rd Street and Broadway.

(8) Post sale expenses of $4,960.59 paid in 1926 have been allowed during the current year and are made up of $4,500.00 expenses
21 in connection with the property, 180th Street and Boston Road, sold in 1925, and $460.59 of sundry accruals.

(9) Depreciation of the property, 83rd Street and Broadway, has been increased by $9,625.12.

(10) Depreciation has been increased from 2% to 3% in accordance with the computation as set out in item F, Schedule 5-A, revised.

(11) See explanation of item (8) for the year 1924.

Fees incurred:		
Listed in accordance with your schedule	$88,076.25	
83rd Street and Broadway property	161,550.00	
	$249,626.25	
Less: Deductions taken on return per schedule	103,142.33	
Difference	$146,483.92	
Computation of tax:		
Net income	$261,133.74	
Less: Exemption	None.	
Balance taxable at 13%	$261,133.74	
Tax liability	$33,947.39	
Original assessment	None.	
Deficiency	$33,947.39	

22 The right of petition as indicated on page one of this letter refers only to any deficiency in tax indicated herein, inasmuch as there is no provision in the revenue act of 1926 granting the right of petition against the determination of any overassessment found upon an audit of your return.

The overassessment shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 284 of the revenue act of 1926.

A copy of this communication has been furnished your representative, Mr. George W. Perper, 11 West 42nd Street, New York, New York.

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Now, March 7, 1931, the foregoing petition certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

23 Before United States Board of Tax Appeals

[Title omitted.]

Answer

Filed April 2, 1929

Admits the allegation contained in paragraph 1 of the petition.

Admits the allegation contained in paragraph 2 of the petition.

Admits that the deficiency is for income taxes for the calendar years 1924 and 1925 as alleged in paragraph 3 of the petition, but denies that the amount thereof is $7,986.89.

Denies the allegations of error as set forth in paragraph 4 of the petition.

Denies all the allegations of fact contained in paragraph 5 of the petition.

Denies each and every allegation of fact contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore it is prayed that the determination of the commissioner be approved and that the appeal be dismissed.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

24 Of counsel:
F. R. SHEARER,
E. L. CORBIN,
Special Attorneys, Bureau of Internal Revenue.

Now, March 7, 1931, the foregoing answer certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Amended petition

Filed Feb. 14, 1930

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:FAR:A-6-MN-60D) dated
25 February 4, 1928, and as a basis of its proceedings alleges as follows:

1. The petitioner is a New York corporation with its principal office at 2382 Grand Concourse, New York, N. Y.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the taxpayer on February 4, 1928.

3. (A) The amount of the deficiency is $34,342.08 for income taxes for the calendar years 1924 and 1925.

(B) The full amount of this deficiency is in controversy for the reason that for the year 1924 a net loss of $174,226.13 is determined and for the year 1925 a net loss of $131,959.39 is determined after applying the statutory net losses found for the year 1923 of $100,-152.76 and for the year 1924 of $174,226.13.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(A) The commissioner in his 60-day letter attached hereto allowed mortgage fees to be deducted in the years incurred, but failed to allow the full amount of mortgage fees incurred on mortgage loans in connection with 82nd St. & Broadway and 83rd St. & Broadway properties.

(B) The commissioner has in error allowed as a deduction
26 the fees on mortgage loans in connection with 82nd St. & Broadway and 83rd St. & Broadway properties in the years 1924 and 1925, instead of in the years 1923 and 1924, respectively, when said mortgage fees were incurred.

(C) That the statutory net loss for the year 1923, allowed as a deduction by the commissioner in the year 1924, has been incorrectly computed.

(D) The commissioner failed to eliminate from the 1924 income an item representing adjustments of cost of premises, 2608 Creston Avenue, sold by petitioner in the year 1922.

(E) The commissioner incorrectly computed taxable profit on Broadway & 83rd St. property sold in the year 1925 by his failure to properly apply the installment-sales provision of the law.

(F) The commissioner incorrectly computed the taxable profit on Broadway & 82nd St. property sold in the year 1924 by his failure to properly apply the installment-sales provision of the law.

5. The facts upon which the taxpayer relies as the basis of this proceeding are as follows:

(A) The total fees incurred on mortgage loans in connection with 82nd St. & Broadway property amounted to $97,627.50. The commissioner in error allowed as a deduction only $91,008.75.

27 (B) The total fees incurred on mortgage loans in connection with 83rd St. & Broadway property amounted to $179,500.00. The commissioner, in error, allowed as a deduction only $161,550.00.

(C) The mortgage fees of $97,627.50 re 82nd St. & Broadway loan were incurred in the year 1923, and the mortgage fees of $179,500.00 re 83rd St. & Broadway loan were incurred in the year 1924. The commissioner allowed as a deduction in the 60-day letter (Exhibit A, page 3, attached hereto) only $65,849.54 for fees incurred in the year 1923. The correct amount of fees incurred in the year 1923 is $163,477.04, a difference of $97,627.50. For the year 1924 the commissioner allowed as a deduction in the 60-day letter (Exhibit A, page 5, attached hereto) only $101,533.75 for fees incurred in the year 1924. The correct amount of fees incurred in the year 1924 is $190,025.00, a difference of $88,491.25. For the year 1925 the commissioner allowed as a deduction in the 60-day letter (Exhibit A, page 7, attached hereto) $249,626.25 for fees incurred in the year 1925. The correct amount of fees incurred in the year 1925 is $88,076.25, a difference of $161,550.00, representing excess deductions allowed by the commissioner.

(D) The statutory net loss for 1923 of $2,525.26 (see Exhibit A, page 5, hereto attached) should be increased by $97,627.50 (see C above, relating to correct amount of mortgage fees to be deducted for the year 1923), resulting in a correct statutory net loss of

28 $100,152.76. This net loss should be applied in accordance with section 206 of the revenue act of 1924.

(E) Petitioner filed on March 5th, 1928, a claim for refund for the year 1923, in the amount of $5,255.31, showing thereon that the correct statutory net loss for said year 1923 amounts to $100,152.76, which amount should be applied in accordance with section 206 of the revenue act of 1924.

(F) There has been included as income on page 1 of schedules attached to the 1924 corporation income-tax return filed by petitioner an item of $3,336.81 with the following explanation: "Premises 2608 Creston Avenue, sundry allowances received from contractors after sale of premises."

(G) The property of 2608 Creston Avenue consisted of land and building which was constructed by petitioner. Said property was sold in the year 1922.

(H) The amount of $3,336.81 represents the aggregate reduction of cost of the property 2608 Creston Avenue, due to returns of furniture and equipment, sundry allowances, and adjustments of construction contracts.

(I) The adjustments of $3,336.81, above referred to, reducing cost of premises 2608 Creston Avenue, were not made on the books of the company until the year 1924.

29 (J) The commissioner failed to eliminate from 1924 income the aggregate adjustments of $3,336.81 on property 2608 Creston Avenue sold in 1922. On the other hand, the commissioner eliminated a deduction taken by the petitioner on page three (3) of schedules attached to the 1923 income-tax return filed by them, an item of $230.11. The explanation on the tax return for this of $230.11 is as follows: " Premises 2608 Creston Avenue (& 193rd St.); sundry adjustments in 1923, premises sold in 1922."

(K) The premises located at 83rd St. & Broadway was sold by petitioner April 15th for $2,165,000.00.

(L) The mortgages existing on the 83rd St. & Broadway property at the time of the sale amounted to $1,600,000.00, consisting of 1st mortgage $1,100,000.00, and 2nd mortgage of $500,000.00, assumed by the purchaser.

(M) The petitioner received from the purchaser during the taxable year 1925 on the sale of 83rd St. & Broadway property a purchase-money mortgage of $265,000.00, on account of which $2,000.00 of cash installments were paid during the year 1925. The petitioner also received $300,000.00 in cash from purchaser on the sale from said premises, making total cash received from the purchaser during the year 1925 $302,000.00.

In addition thereto the purchaser of the 83rd St. & Broadway property paid during the year 1925 to the mortgagee an installment of $22,500.00 on account of the 2nd mortgage.

30 (N) The gross profit on sale of 83rd St. & Broadway after deducting from the purchase price the net cost of $1,522,033 amounts to $642,967.00.

(O) The total contract price on sale of 83rd St. & Broadway property amounts to $2,165,000.00. Petitioner refers to the decision in the case of S. J. Snyder, Trustee of the Estate of Bagby-Howe Drug Co., Bankrupt, vs. Robert H. Lucas, Collector of Internal Revenue for the Collection District of Kentucky, defendant, decided in the District Court of the United States for the Western District of Kentucky, August 3rd, 1929, decision #1068.

(P) The initial payment on sale of 83rd St. & Broadway property amounts to $324,500.00 (cash received on sale $300,000.00; installment received on purchase-money mortgage $2,000.00; installment paid on 2nd mortgage $22,500.00).

(Q) The gross profit of $642,967.00 to be realized on sale of 83rd St. & Broadway property is .29698245% of contract price of $2,165,000.00.

(R) The correct amount of profit computed according to the installment method and in accordance with the S. J. Snyder decision above referred to, applicable to the year 1925 on the sale of 83rd St. & Broadway property, is $96,370.80.

(S) The petitioner included in his 1925 income-tax return a profit of only $2,234.56 on the sale of 83rd St. & Broadway property.

31 (T) The commissioner reported a profit in the year 1925 on the sale of 83rd St. & Broadway property of $379,967.00 and

increased the profit reported by the taxpayer of $2,234.56 by $377,732.44. (Exhibit A, page 6, item #1.) The correct increase in taxable profit for the year 1925 should be $96,370.80 instead of $377,732.44, a difference of $281,361.64.

(U) (a) The premises at 82nd St. & Broadway were sold in the year 1924 for $2,100,000.00.

(b) The gross profit after deducting the net cost of $1,541,323.48 amounts to $558,676.52.

(c) The total contract price is $2,100,000. The initial payment in 1924 amounts to $352,000.00 (cash received on sale $300,000.00, installment of $30,000.00 received on purchase-money mortgage, and installment paid on first mortgage assumed $22,000.00).

(d) The gross profit of $558,676.52 to be realized on the sale of 82nd St. & Broadway property is .26603644% of the total contract price of $2,100,000.00 (based upon S. J. Snyder decision referred to above).

(e) The correct amount of profit applicable to the year 1924 is $93,644.83 instead of $184,363.25, as determined by the commissioner in his 60-day letter (see Exhibit A, page 3, item #2), a difference of $90,718.42.

(f) The correct amount of profit applicable to the year 1925 is $21,349.42 (.26603644% of $80,250.00, consisting of installment on purchase-money mortgage received in 1925 of $36,250 and
32 installment paid on first mortgage by purchaser to mortgagee of $44,000.00) instead of $20,252.02, as determined by the commissioner in his 60-day letter (see Exhibit A, page 6, item #2), a difference of $1,097.40, representing an additional amount of income for the year 1925 to be reported.

6. Wherefore, the petitioner prays that this board may hear the proceedings and determine that mortgage fees shall be allowed as a deduction in the years incurred and the proper amounts to be deducted for the years involved are: $163,477.04 for the year 1923, $190,025.00 for the year 1924, $88,076.25 for the year 1925; that the statutory net loss for the year 1923 to be applied to the subsequent years according to law is $100,152.76; that the item of $3,336.81 included as income for the year 1924 be eliminated from said year; that the S. J. Snyder case referred to herein be applied in determining the proper method for reporting income on the installment plan and according to this method the correct amount of taxable profit to be reported on 82nd St. & Broadway applicable to the year 1924 is $93,644.83, and for the year 1925 $21,349.42; and on 83rd St. & Broadway for the year 1925 $96,370.80; that there are no deficiencies for the years 1924 and 1925.

GEORGE W. PERPER,
Counsel for Petitioner,
11 West 42nd Street, Manhattan Borough, New York City.

33 [*Duly sworn to by Sam Minskoff; jurat omitted in printing.*]

34 *Exhibit A to amended petition*

[SEAL.]

Address reply to Commissioner of Internal Revenue and refer to IT:FAR:A-6-MN-60D.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Feb. 4, 1928.

S. AND L. BUILDING CORPORATION,
2382 Grand Concourse, New York, N. Y.

SIR: In accordance with section 274 of the revenue act of 1926 you are advised that the determination of your tax liability for the years 1923, 1924, and 1925 discloses a deficiency of $34,342.08 for the years 1924 and 1925 and an overassessment of $5,255.31 for the year 1923, as shown in the attached statement.

The section of the law above mentioned allows you an appeal to the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter. However, if you acquiesce in this determination, you are requested to execute the enclosed Form
35 A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,

D. H. BLAIR, *Commissioner*,
By C. B. ALLEN,
Deputy Commissioner.

Enclosures: Statement; Form A; Form 882.

STATEMENT

IT:FAR:A-6-MN-60D.
In re S. and L. Building Corporation, 2382 Grand Concourse, New York, New York.

Year	Deficiency in tax	Overassessment
1923		$5,255.31
1924	$394.69	
1925	33,947.39	
Total	34,342.08	5,255.31

Net deficiency, $29,086.77

Reference is made to your protest dated October 27, 1927, against the determination of your tax liability as set forth in bureau
36 letter dated October 21, 1927, covering the years 1923 to 1925, inclusive.

You are advised that after due consideration of your protest, together with the information submitted during the conference held November 16, 1927, and the subsequent information submitted in your brief dated December 15, 1927, your tax liability has been redetermined in accordance with your contentions wherein the fees for raising mortgage loans were allowed as a deduction in the year in which incurred.

The result of the determination, in accordance with the foregoing conclusion, is as follows:

1923		
Net income as reported		$42,042.53
Additions:		
1. 1922 expenses	$230.11	
2. Profit on sale of real estate	14,000.00	14,230.11
		$56,272.64
Deductions:		
3. Excessive profit on sale of real estate	$5,987.27	
4. Post sale expenses	32.25	
5. Additional depreciation, 82nd Street and Broadway	8,418.74	
6. Increase depreciation	10,054.84	
7. Expenses paid in 1926	1,000.00	
8. Excess of fees incurred and paid	33,815.41	59,308.51
Net income as adjusted (loss)		(83,035.87)

37 EXPLANATION OF ADJUSTMENTS

(1) This represents 1922 expenses of post sale items paid in 1923 in connection with property which was sold in 1922.

(2) Since the profit on sale of northwest corner of Kingsbridge Road and Creston Avenue is a completed transaction, which sale was consumated during the year 1923, the amount of $6,000.00 received during the year 1924 and the amount of $8,000.00 received during the year 1925 have been considered income during the current year and the income for the years 1924 and 1925 has been reduced by $6,000.00 and $8,000.00, respectively.

(3) The property of 2055–2065 Creston Avenue having been sold and treated as a completed transaction during the year 1923, the bills for furnishings and equipment amounting to $5,987.27, which were received and paid during the year 1924, have been allowed as a deduction for the current year.

(4) Post sale expenses of $32.25 represents items paid in 1924 in connection with the property at northwest corner of Kingsbridge Road and Creston Avenue, which was sold in 1923.

(5) In accordance with your claim for additional depreciation on property, 82nd Street and Broadway, your contention has been allowed and depreciation increased in the amount of $8,418.74 in accordance with Schedule 1–A, revised, of the revenue agent's report.

38 (6) Increased depreciation has been allowed at the rate of 3%, as claimed in your brief. The increase of $10,054.84, as set forth by the agent in his report under item D, Schedule 1-A, revised, has been reviewed and approved.

(7) The item of $1,000.00 as expenses paid during the year 1926, account of northwest corner Kingsbridge Road and Creston Avenue, has been allowed.

(8) This item represents the excess of the mortgage expense fees incurred and paid over the amount deducted on the return. This is allowed in accordance with your protest and computed as follows:

Fees incurred (in accordance with your schedule attached to your letter dated December 15, 1927)		$65,849.54
Less:		
Deductions taken on return	$25,415.38	
82nd Street and Broadway	6,618.75	32,034.13
Difference		$33,815.41
Computation of tax:		
Net income (loss)		($3,035.87)
Tax liability		None.
Original assessment, account #404739		85,255.31
Overassessment		85,255.31

39 1924

Net income as reported (loss)		($67,574.31)
Additions:		
1. Additional cost of 2055-2065 Creston Avenue	$5,987.27	
2. Profit on sale of premises 82nd Street and Broadway	184,363.25	
3. Expenses northwest corner Kingsbridge Road and Creston Avenue	32.25	190,382.77
Total		$122,808.46
Deductions:		
4. Purchase-money mortgage receipts	$6,000.00	
5. Commissions, etc	22,217.00	
6. Depreciation, 82nd Street and Broadway	2,806.25	
7. Depreciation, 83rd Street and Boradway	8,250.10	
8. Increase depreciation	11,186.55	
9. Excess of fees incurred and paid	64,665.75	115,125.65
Net income as adjusted		$7,682.81

EXPLANATION OF ADJUSTMENTS FOR 1924

(1) See explanation of item (3) for the year 1923.

40 (2) The profit on the sale of the premises, 82nd Street and Broadway, has been approved as computed by the agent, the details of which are shown in Exhibit O, revised and amended.

(3) See explanation of item (4) for the year 1923.

(4) See explanation of item (2) for the year 1923.

(5) Commissions, etc., have been increased by $22,217.00 to allow as a deduction the expenses of sale of property, 82nd Street and Broadway, which expenses were deferred until 1925.

(6) Depreciation on the property at 82nd Street and Broadway has been allowed in the amount of $2,806.25 up to February 1, 1924, date of sale of property.

(7) Depreciation on the property at 82nd Street and Broadway has been increased by $8,250.10 to allow depreciation from October 1, 1924, to the end of the year in accordance with details as set out by the agent under Schedule 3–A, revised, item D.

(8) Depreciation has been increased from 2% to 3% in accordance with the computation as set forth in the agent's report under item E, Schedule 3–A, revised.

(9) See explanation of item (8) for the year 1923.

41	Fees incurred:		
	1325 Grand Concourse		$10,525.00
	82nd Street and Broadway		91,008.75
	Total		$101,533.75
	Deductions taken:		
	2655 Grand Concourse	$11,838.50	
	180th Street and Boston Road	3,375.00	
	2382 Grand Concourse	2,652.00	
	1325 Grand Concourse	1,052.50	
	Broadway, 82nd and 83rd Streets	17,950.00	36,868.00
	Difference		$64,665.75
	Computation of tax:		
	Net income		$7,682.81
	Less:		
	Net loss (section 206, revenue act of 1924)	$2,525.26	
	Exemption	2,000.00	4,525.26
	Balance taxable at 12½%		$3,157.55
	Tax liability		394.69
	Previously assessed		None.
	Deficiency		$394.69
42	Computation of statutory loss for 1923:		
	Net loss		$3,035.87
	Nontaxable interest		510.61
	Statutory loss		$2,525.26

1925

	Net income as reported (loss)		($28,040.46)
	Additions:		
	1. Profit on real estate, 83rd Street and Broadway	$377,732.44	
	2. Profit on real estate, 82nd Street and Broadway	20,252.02	
	3. Commissions	22,217.00	
	4. Profit on real estate, 180th Street and Boston Road	3,618.92	
	5. Net loss for 1924	67,574.31	$491,394.69
	Total		$463,354.23
	Deductions:		
	6. Purchase-money mortgage receipts	$8,000.00	
	7. Commissions	21,000.00	
	8. Post sale expenses	4,960.59	
	9. Depreciation, 83rd Street and Broadway	9,625.12	
	10. Depreciation, 2665 Grand Concourse	12,150.86	
	11. Excess of fees incurred and paid	146,483.92	202,220.49
	Net income as adjusted		$261,133.74

43 EXPLANATION OF ADJUSTMENTS

(1) Profit on sale of property at 83rd Street and Broadway has been approved as computed by the agent under Exhibit O, revised and amended.

(2) The profit on the sale of property, 82nd Street and Broadway, has been approved as computed by the agent under Exhibit P, revised and amended.

(3) Commissions have been decreased by $22,217.00, representing amount paid on the sale of property at 82nd Street and Broadway and which has been allowed as a deduction during the year 1924.

(4) The profit on sale of property at 180th Street and Boston Road has been increased by $3,618.92 on account of additional depreciation allowed during the years 1923 and 1924.

(5) Since there is a gain disclosed for the year 1924, the net loss as deducted has been disallowed.

(6) See explanation of item (2) for the year 1923.

(7) Commissions have been increased $21,000.00 to allow as an expense the amount paid on the sale of property of 83rd Street and Broadway.

(8) Post sale expenses of $4,960.59 paid in 1926 have been allowed during the current year and are made up of $4,500.00 ex-
44 penses in connection with the property, 180th Street and Boston Road, sold in 1925, and $460.59 of sundry accruals.

(9) Depreciation on the property, 83rd Street and Broadway, has been increased by $9,625.12.

(10) Depreciation has been increased from 2% to 3% in accordance with the computation as set out in item F, Schedule 5-A, revised.

(11) See explanation of item (8) for the year 1924.

Fees incurred:	
Listed in accordance with your schedule	$88,076.25
83rd Street and Broadway property	161,550.00
	$249,626.25
Less: Deduction taken on return per schedule	103,142.33
Difference	$146,483.92
Computation of tax:	
Net income	$261,133.74
Less: Exemption	None.
Balance taxable at 13%	$261,133.74
Tax liability	$33,947.39
Original assessment	None.
Deficiency	$33,947.39

45 The right of petition as indicated on page one of this letter refers only to any deficiency in tax indicated herein, inasmuch as there is no provision in the revenue act of 1926 granting the right of petition against the determination of any overassessment found upon an audit of your return.

The overassessment shown herein will be made the subject of a certificate of overassessment, which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 284 of the revenue act of 1926.

A copy of this communication has been furnished your representative, Mr. George W. Perper, 11 West 42nd Street, New York, New York.

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Now, March 7, 1931, the foregoing amended petition certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

46 Before United States Board of Tax Appeals

[Title omitted.]

Answer to amended petition

Filed Feb. 20, 1930

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, for answer to the amended petition herein admits, denies, and alleges as follows:

1. Admits the allegations contained in paragraph 1 of the amended petition.

2. Admits the allegations contained in paragraph 2 of the amended petition.

3. (A) & (B) Admits that the taxes in controversy are corporation income taxes for the calendar years 1924 and 1925; avers that the commissioner determined deficiencies of $394.60 for 1924 and $33,947.39 for 1925; avers that the commissioner determined
47 an overassessment of $5,255.31 for the year 1923 and in connection therewith determined that deductions from income exceeded gross income for said year in the amount of $3,035.87, and that in determining the said deficiency for 1924 the commissioner allowed a statutory net loss for 1923 in the amount of $2,525.26.

4. (A) & (B) Admits that the commissioner has not allowed the full amount of mortgage expenses and fees incurred in connection with 82nd Street and Broadway and 83rd Street and Broadway properties, and that the allowance of deductions in respect thereof were $91,008.75 in the year 1924 and $161,550.00 in the year 1925; avers that said amounts were erroneously allowed as deductions from income in the years 1924 and 1925, whereas they should properly have been applied as capital adjustments in computing taxable profit from the sales of said properties in 1924 and 1925.

(C) Admits that the commissioner incorrectly computed petitioner's statutory net loss for the year 1923 to be applied as a deduction for the year 1924, and avers that the petitioner did not sustain a net loss for the year 1923.

(D) Denies the allegations of error contained in subparagraph (D) of paragraph 4 of the amended petition.

(E) & (F) Denies the allegations of error contained in subparagraphs (E) and (F) of paragraph 4 of the amended petition
48 unless the contentions of the commissioner hereinafter set forth be sustained in respect of the deductions for mortgage fees and expenses, in which event it is admitted that a downward revision should be made in the profits taxable for the year 1925 on the sale of the property at 83rd Street and Broadway, and for the year 1924 on the sale of the property at Broadway and 82nd Street.

(G) Respondent affirmatively alleges that in determining the deficiencies for the years 1924 and 1925 the commissioner erred as follows:

(1) The commissioner determined that petitioner sustained a net loss for the year 1923 and in computing the same allowed deductions on account of mortgage fees incurred in the year 1923 in the total amount of $65,849.54, whereas the correct amount of the allowable deductions for mortgage fees and expenses incurred in the year 1923 and prior years did not exceed $32,034.13. By reason thereof it should have been determined that the petitioner received taxable net income in the year 1923 and did not sustain a statutory net loss deductible in computing income for the year 1924.

(2) In computing net income for the year 1924 the commissioner allowed deductions on account of mortgage fees and expenses incurred during the year 1924 and prior years in the total amount of $101,533.75, whereas the amount properly deductible on account of such mortgage fees and expenses did not exceed $36,868.00.
49 (3) In computing income for the year 1925 the commissioner allowed deductions from income on account of mortgage fees and expenses incurred in the year 1925 and prior years in the total amount of $249,646.25, whereas the amount properly deductible on account of such mortgage fees and expenses did not exceed $103,142.33.

(4) If it be held that the commissioner erred as alleged in subparagraphs (1), (2), and (3) above, the respondent admits that downward revisions should be made in the taxable profits realized in the years 1924 and 1925 on account of the sale of the premises at 82nd Street and Broadway and 83rd Street and Broadway by adjusting the cost basis of the property at 82nd Street and Broadway by the sum of $91,008.75, and by adjusting the cost basis of the property at 83rd Street and Broadway by the sum of $161,550.00, representing unamortized mortgage fees and expenses in relation to said properties.

5. (A) Admits that the total mortgage fees in connection with 82nd Street and Broadway property amounted to $97,627.50 and that

the commissioner has allowed as a deduction in the year 1924 the amount of $91,008.75 on account thereof.

(B) Admits that the total mortgage fees in connection with 83rd Street and Broadway property amounted to $179,500.00 and that the commissioner has allowed as a deduction in the year 1925 the amount of $161,550.00 on account thereof.

50 (C) Admits the allegations of fact contained in subparagraph (C) of paragraph 5 of the amended petition, but denies that said mortgage fees constituted in their entirety ordinary and necessary expenses of petitioner's business in the respective years in which incurred.

(D) & (E) Denies that any amount of said mortgage fees and expenses re 82nd Street and Broadway in excess of $6,618.75 should have been allowed as a deduction in the year 1923; denies that the petitioner sustained a statutory net loss for 1923 of $100,152.76 or any other amount which should be applied as a deduction in computing income for 1924 under section 206 of the revenue act of 1924.

(F) Admits the allegations contained in subparagraph (F) of paragraph 5 of the amended petition.

(G) & (H) Denies the allegations contained in subparagraphs (G) and (H) of paragraph 5 of the amended petition.

(I) Admits that the said item of $3,336.81 was entered on the petitioner's books in the year 1924.

(J) Admits that the commissioner failed to eliminate from 1924 income said item of $3,336.81.

(K) & (L) Admits the allegations contained in subparagraphs (K) and (L) of paragraph 5 of the amended petition.

51 (M) Admits the allegations contained in subparagraph (M) of paragraph 5 of the amended petition, and alleges that in addition thereto the petitioner received and realized in the year 1925 the equivalent of cash in the amount of $77,967.00 by reason of the assumption by the purchaser of the mortgages on said premises, the mortgages so assumed being to secure loans in the amount of $1,600,000 obtained by the petitioner in the year 1924, the amount thereof exceeding the basis of said property to the taxpayer by the amount of $77,967.00.

(N) Admits the allegations contained in subparagraph (N) of paragraph 5 of the amended petition except that it is conceded (in the event it be finally held that unamorftized mortgage fees in the amount of $161,550.00 should be used as an adjustment to cost in computing profit from said sale) that the gross profit on said sale would be $481,417.00 instead of the amount alleged in sub-paragraph (N).

(O) Denies the allegations contained in sub-paragraph (O) of paragraph 5 of the amended petition, and alleges that the total "contract price" computed in accordance with the law and regulations (if no adjustment be made on account of unamortized mortgage fees) is $565,000.00 plus $77,967.00, a total of $642,967.00.

(P) Denies the allegations contained in sub-paragraph (P) of paragraph 5 of the amended petition; alleges that under the law and regulations the initial payment (if no adjustment be
52 made on account of unamortized mortgage fees) was $300,000.00 plus $77,967.00 (the excess of the mortgages assumed over the basis), and that during the year 1925 the petitioner received payments of installments on the purchase-money mortgage in the amount of $2,000.00.

(Q), (R), & (T) Denies (in the event it be held that no adjustment should be made on account of unamortized mortgage fees) that the taxable profit for 1925 on the installment basis on account of the sale of the premises at 83rd Street and Broadway is less than $379,967.00, as determined by the commissioner.

(S) Admits the allegations contained in sub-paragraph (S) of paragraph 5 of the amended petition, and avers that in determining the deficiency for 1925 the commisioner gave credit for the amount of said profit so reported.

(U) (a) and (b) Admits the allegations contained in sub-sections (a) and (b) of sub-paragraph (U) of paragraph 5 of the amended petition, except it is conceded (in the event it be finally held that unamortized mortgage fees in the amount of $91,008.75 should be used as an adjustment to cost in computing profit from said sale) that the gross profit on said sale would be $467,667.77 instead of the amount alleged in sub-section (b).

(c) & (d) Denies the allegations contained in sub-sections (c) and (d) of sub-paragraph (U) of paragraph 5 of the amended
53 petition; alleges that under the law and regulations the total contract price was $1,000,000.00, and the initial payment $300,000.00, and that during the year of sale the petitioner received an installment of $30,000.00 on the purchase-money mortgages.

(e) & (f) Denies (in the event it be held that no adjustment should be made on account of unamortized mortgage fees) that the taxable profits for 1924 and 1925 on the installment basis on account of the sale of the premises at 82nd Street and Broadway are less than $184,363.25 and $20,252.02, respectively, as determined by the commissioner, but admits that the taxable profit for 1925 on account thereof should be increased if the petitioner's contention in said respect be finally allowed.

Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore admitted, qualified, or denied.

6. Respondent further alleges as follows:

During all times material hereto the business of the petitioner consisted of the acquisition, improvement, rental, operation, and sale of real estate. Its income consisted principally of interest on investments, rentals from properties so rented and operated, and profits on the sale of improved real estate. During 1923, 1924, and 1925 and prior thereto the petitioner, in order to finance the conduct of

its business, including the construction of improvements on its real estate, obtained a number of loans, securing the same by mortgages upon its real estate and by pledging purchase-money mort-
54 gages receivable on other real estate already sold. In order to obtain such loans, the petitioner incurred and paid certain fees, bonuses, or commissions, which were accrued on its books under the designation of "prepaid raising mortgage expense," and which will be hereinafter referred to for convenience as "mortgage fees." The purposes of said loans were to pay off existing mortgages on properties, to pay current obligations in the form of notes and open accounts to contractors for construction work, to purchase additional properties, and to pay general operating expenses of the company. The cash received from these loans was merged with other cash received from rental income, sale of properties, and other sundry income, and out of the entire cash funds withdrawals were made from time to time for the above-mentioned purposes.

At all times material hereto the petitioner employed the accrual method of accounting in keeping its books and records, and in making its Federal income tax returns. On its books and in its returns the above-mentioned mortgage fees were capitalized as prepaid expense, and amortized by way of deductions from income over the lives of the respective loans; and in the case of the sale and disposition of any of the mortgaged property the unamortized portion of the mortgage fees relating thereto was written off at the time of such sale. The unamortized amount of said mortgage fees as of December 31, 1922, as shown by the petitioner's books, was $44,500.84. The correct amounts of said mortgage fees to be amortized and deducted from income in the years 1923, 1924, and 1925 are as follows:

55 1923—$32,034.13, including $6,618.75 applicable to petitioner's property at 82nd Street and Broadway.
1924—$36,858.00, including $17,950.00 applicable to petitioner's property at 83rd Street and Broadway.
1925—$103,142.33.

In determining the deficiencies the commissioner allowed deductions on account of said mortgage fees as follows:

1923	$65,849.54
1924	101,533.75
1925	249,626.25

In determining the deficiency for 1924 the commissioner found that the petitioner's statutory deductions for 1923 exceeded its gross income for 1923 by the amount of $3,035.87 and allowed in the year 1924 a statutory net loss of $2,525.26.

During the year 1924 the petitioner sold and disposed of its property at 82nd Street and Broadway and at the time of said sale the unamortized mortgage fees in respect of the mortgages on said property amounted to $91,008.75. The profit from said sale was determined by the commissioner to be properly computed on the installment basis. Respondent avers that the amount of said un-

amortized mortgage fees should properly be applied as an adjustment to the cost basis of the property in computing the profit from said sale, and that said sum should not be allowed as an ordinary expense deduction in 1924 or in any other year. During the year 1925
56 the petitioner sold and disposed of its property at 83rd Street and Broadway and at the time of said sale the unamortized mortgage fees in respect of the mortgages on said property amounted to $161,550.00. The profit from said sale was determined by the commissioner to be properly computed on the installment basis. Respondent avers that the amount of said unamortized mortgage fees should properly be applied as an adjustment to the cost basis of the property in computing the profit from said sale, and that said sum should not be allowed as an ordinary expense deduction in 1925 or in any other year.

Wherefore, it is prayed that the board determine that the petitioner did not sustain a statutory net loss for 1923, and that the board redetermine the correct amounts of the deficiencies for the years 1924 and 1925 even though the amounts thereof be greater than the deficiencies determined by the commissioner.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of counsel:
F. R. SHEARER,
Special Attorney, Bureau of Internal Revenue.

Now, March 7, 1931, the foregoing answer to amended petition certified from the record as a true copy.

[SEAL.]
B. D. GAMBLE.
Clerk, U. S. Board of Tax Appeals.

57 Before United States Board of Tax Appeals

Docket No. 36950. Promulgated April 30, 1930

S. AND L. BUILDING CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Findings of fact and opinion

19 B. T. A.—

1. MORTGAGE FEES.—Commissions and fees for securing loans on mortgages are not deductible in full in the year when paid or incurred, but should be spread proportionately over the life of the mortgages and when the mortgages are paid off or the property sold and the mortgage assumed by a third person, the unamortized portion of such mortgage fees may be charged off and deduction taken from gross income.

2. INSTALLMENT SALE—MORTGAGE.—In the case of an installment sale of mortgaged realty the amount of the mortgage must be deducted from the original agreed consideration to arrive at the total contract price in order to fix the basis for computation of the percentage of profit.

58 3. ACCOUNTING.—Where petitioner reported certain contract adjustments as income for 1924, and this was in accordance with its method of accounting and respondent made no change relative thereto, no change will now be made on petitioner's claim that they should have been reported for a previous year.

George W. Perper, C. P. A., for the petitioner.

F. R. Shearer, Esq., for the respondent.

Petitioner seeks redetermination of deficiencies of $394.69 for the calendar year 1924 and $33,947.39 for the year 1925. Respondent determined an overassessment for 1923 in the amount of $5,255.31. Respondent amended his pleadings and is claiming increased deficiencies for the years 1924 and 1925. The calendar year 1923 is involved herein on account of the respective claims of the parties in respect of a statutory net loss for the year 1923 deductible in computing taxable net income for the succeeding years.

The matters in controversy relate to the following:

(*a*) The proper treatment in computing income for the calendar years 1923, 1924, and 1925 of certain expenditures incurred by the petitioner in obtaining loans as hereinafter set forth.

(b) The proper computation of installment sales income on
59 account of the sale of the petitioner's property at 82nd Street and Broadway.

(c) The proper computation of installment sales income on account of the sale of the petitioner's property at 83rd Street and Broadway.

(d) Whether an item of $3,336.81 or any part thereof, referred to in the petition, should be eliminated from income for the year 1924.

Part of the facts in this proceeding were developed at the hearings and part were stipulated by the parties.

FINDINGS OF FACT

The petitioner is a New York corporation with its principal office at 2382 Grand Concourse, New York, New York.

During all times material hereto the business of the petitioner consisted of the acquisition, improvement, rental, operation, and sale of real estate. Its income consisted principally of interests on investments, rentals from properties so rented and operated, and profits on the sale of improved real estate. During 1923, 1924, and 1925 and prior thereto, the petitioner, in order to finance the conduct of its business, including the construction of improvements on its real estate, obtained a number of loans, securing the same by mortgages upon its real estate and by pledging purchase-money mort-
60 gages receivable on other real estate already sold. In order to obtain such loans the petitioner incurred and paid certain fees,

bonuses, or commissions, which were accrued on its books under the designation of "prepaid raising mortgage expense," and which will be hereinafter referred to for convenience as "mortgage fees." The purposes of said loans were to pay off existing mortgages on properties, to pay current obligations in the form of notes and open accounts to contractors for construction work, to purchase additional properties, and to pay general operating expenses of the company. The cash received from those loans was merged with other cash received from rental income, sale of properties, and other sundry income, and out of the entire cash funds withdrawals were made from time to time for the above-mentioned purposes.

At all times material hereto petitioner employed the accrual method of accounting in keeping its books and records, and in making its Federal income tax returns. On its books and in its returns the above-mentioned mortgage fees were capitalized as prepaid expense, and amortized by way of deductions from income over the lives of the respective loans; and in the case of the sale and disposition of any of the mortgaged property the unamortized portion of the mortgage fees relating thereto was written off at the time of such sale. The unamortized amount of said mortgage fees as of December 31, 1922, as shown by the petitioner's books, was $44,500.84.

During the years 1923, 1924, and 1925 the petitioner obtained the following-described loans and incurred mortgage fees as follows:

61

	Amount to loan	Term of loan	Mortgage fees incurred in obtaining loan
1923			
2665 Grand Concourse	$175,000.00	5 years	$30,000.00
180th St. & Boston Road:			
1st mortgage	220,000.00	10 years	7,750.00
2nd mortgage	60,000.00	5 years	13,000.00
184th St. & Grand Concourse:			
1st mortgage	45,000.00	5 years	4,614.54
2nd mortgage	50,000.00	6 years	10,485.00
82nd St. & Broadway:			
1st mortgage	1,100,000.00	10 years	56,167.50
2nd mortgage	200,000.00	7 years	41,460.00
Total			$163,477.04
1924			
1325 Grand Concourse	$260,000.00	10 years	$10,525.00
83rd St. & Broadway:			
1st mortgage	1,100,000.00	10 years	54,250.00
2nd mortgage	500,000.00	10 years	125,250.00
Total			$190,025.00
1925			
S. E. corner of 101st St. & Broadway	$1,900,000.00	On demand	$63,593.50
205 W. 100th St.	35,000.00	1 year	932.49
206 W. 101st St	90,000.00	1 year	2,143.26
General loan	125,000.00	2 years	13,750.00
General loan	100,000.00	1 year	5,157.00
General loan	50,000.00	2 years	2,500.00
Total			$88,076.25

62 If it be held as a matter of law that such mortgage fees are deductible in computing taxable income entirely in the year in which incurred, the parties are agreed that the amounts hereinabove set forth are the correct amounts to be used in computing the deductions on that account.

If, as a matter of law, said mortgage fees should properly be capitalized and amortized over the lives of the loans, and the unamortized portion written off at the time the mortgaged property is disposed of, the parties are agreed that the correct amounts so deductible in computing taxable income for the years 1923, 1924, and 1925 (including the amounts deductible in said years on account of mortgage fees incurred prior to 1923, as set forth in the second preceding paragraph) are as follows:

	1923	1924	1925
2665 Grand Concourse	$9,338.50	$11,838.50	$11,838.50
180th St. & Boston Road	1,668.00	3,375.00	15,707.00
184th St. & Grand Concourse	928.33	2,652.00	2,652.00
Kingsbridge & Fordham	733.34		
2055-2065 Creston Ave	12,747.21		
82nd St. & Broadway	6,618.75	91,008.75	
1325 Grand Concourse		1,052.50	1,052.50
83rd St. & Broadway		17,950.00	161,550.00
S. E. corner 101st St. & Broadway			63,593.59
205 W. 100th St			932.49
206 W. 101st St			2,143.26
Three general loans described in preceding paragraph			5,223.08
Totals	$32,034.13	$127,876.75	$264,692.33

63 During the year 1924 the petitioner sold and disposed of the premises at 82nd Street and Broadway. The sales price was $2,100,000 made up as follows:

Cash	$300,000.00
First mortgage assumed	1,100,000.00
Purchase-money mortgage given by purchaser	700,000.00
Total	2,100,000.00

Said property was acquired by the taxpayer after March 1, 1913. Its depreciated cost at the time of sale (without adjustment on account of unamortized mortgage fees) was $1,541,323.48, leaving a profit to be reported (without adjustment on account of said mortgage fees) in the amount of $558,676.52. The respondent contends that in computing the profit on the sale of these premises an adjustment to cost should be made on account of unamortized mortgage fees incurred in 1923 in respect of said property. The parties are agreed that the correct amount of such unamortized mortgage frees in the year of sale is $91,008.75, if it be held that such mortgage fees should not have been deducted in their entirety in the year 1923. If such adjustment be proper, the net depreciated cost was $1,632,332.23, leaving a profit to be reported on account of said sale in the amount of $467,667.77. If it be held that said mortgage fees are deductible in the year 1923 when incurred, or if it be held that said unamortized portion thereof is deductible as ex-

64 pense in the year of sale (rather than being taken into consideration as an adjustment of the profit on the sale) then the parties are agreed that the correct profit would be $558,676.52 as above stated. In addition to the cash of $300,000 received at the time of sale, the taxpayer received during the year 1924 the amount of $30,000 as installments on the purchase-money mortgage. During the year 1925 the petitioner received payments on said purchase-money mortgage in the amount of $36,250. The mortgage of $1,100,000 assumed by the purchaser provided that the principal sum thereof was payable in installments of $22,000 on December 1, 1924, and $22,000 every six months thereafter until April 9, 1933, when the entire balance should become due and payable. In accordance with the agreement of sale the purchaser paid to the holders of said mortgage in 1924 the amount of $22,000, and in 1925, the amount of $44,000.

During the year 1925 the petitioner sold and disposed of the premises at 83rd Street and Broadway. The sales price was $2,165,000, made up as follows:

Cash	$300,000.00
First mortgage assumed	1,100,000.00
Second mortgage assumed	500,000.00
Purchase-money mortgage given by purchaser	265,000.00
Total	$2,165,000.00

Said property was acquired by the taxpayer after March 1,
65 1913. Its depreciated cost at the time of sale (without adjustment on account of unamortized mortgage fees) was $1,522,033.00, leaving a profit to be reported (without adjustment on account of said mortgage fees) in the amount of $642,967. In addition to the cash payment of $300,000, the petitioner received on the purchase-money mortgage during the year 1925 the sum of $2,000. If no adjustment be made in the year of sale on account of unamortized mortgage fees, the first and second mortgages assumed by the purchaser exceeded the basis of such property to the taxpayer in the amount of $77,967. In connection with this sale the respondent makes the same contention, in regard to an adjustment to cost in respect to unamortized mortgage fees incurred in 1924, as set forth in the preceding paragraph, in connection with the sale of the premises at 82nd Street and Broadway. If an adjustment on account of unamortized mortgage fees be proper in computing profit from the sale of said property, the parties are agreed that the correct amount to be used in said adjustment is $161,550, which would result in a net depreciated cost of $1,683,583, leaving a profit to be realized in the amount of $481,417. The loan secured by the first mortgage on said property in the amount of $1,100,000 was obtained by the petitioner in the year 1924, the terms thereof providing that the principal sum should be payable in installments of $16,500, payable May 1, 1926, and $16,500 every six months thereafter until April 9, 1933, when the entire balance should

become due and payable. The loan secured by the second
66 mortgage on said property in the amount of $500,000 was obtained by the petitioner during the year 1924, and provided that the principal sum should be payable in installments of $7,500 on May 7, 1925, and $7,500 every three months thereafter until November 7, 1934, when the entire balance should become due and payable. In the year 1925 the purchaser paid to the holders of the second mortgage the amount of $22,500 in respect to said installments.

In determining the deficiencies the respondent included in the petitioner's income for the year 1924 a realized profit on the sale of the property at 82nd Street & Broadway in the amount of $184,363.25, computed on the installment basis as follows:

Profit to be realized	$558,676.52
Contract price	1,000,000.00
Percentage of profit	55.867652%
Cash payment plus installments received on purchase-money mortgage	$330,000.00
55.867652% times $330,000 equals	$184,363.25

In determining the deficiencies the respondent included in the petitioner's income for the year 1925 realized profit on account of the sale in 1924 of said property at 82nd Street and Broadway in the amount of $20,252.02, computed by multiplying the installment payments received during 1925 in the amount of $36,250 by 55.867652 per cent.

In computing the deficiencies the respondent included in the
67 petitioner's income for the year 1925 profits realized on the sale during the year 1925 of said property at 83rd Street and Broadway in the amount of $379,967 computed on the installment basis as follows:

Profit to be realized	$642,967.00
Contract price (without adjustment on account of excess of mortgages assumed over the basis)	565,000.00
Percentage of profit	100% plus
Initial payment	300,000.00
Installments received on purchase-money mortgage	2,000.00
Liability on bond and mortgage cancelled (being the excess of the mortgages assumed over the basis of the property to the taxpayer)	77,967.00
Profit to be reported, 1925	379,967.00

On petitioner's income-tax return for the year 1924 there was reported as income an item reading as follows:

Premises No. 2608 Creston Ave., sundry allowances received from contractor after sale of premises	$3,336.81

In determining the deficiencies the respondent made no adjustment in respect to this item and did not eliminate the amount from the petitioner's income for the year 1924.

This item is in connection with a building which petitioner
68 constructed at No. 2608 Creston Avenue during 1922, which was completed in December of that year. Final settlement was not made with a number of contractors and material men until

1924, when certain allowances were made to petitioner by the contractors for excess material returned, omission of work or inferior work or material, or other causes. These allowances aggregated $3,336.81 and were credited to profit and loss by petitioner and returned by it as income for 1924. This was in accordance with the regular method and practice of petitioner in keeping its accounts, up to that time; viz, these adjustments were set up after the building was completed and sold, and were entered as of the time when made.

In determining the deficiencies the respondent allowed as a deduction in computing taxable net income for the year 1924 a statutory net loss sustained in 1923 computed as follows:

Net loss (before adjustment for non-taxable item)	$3,035.87
Non-taxable interest	510.61
Statutory net loss	$2,525.26

It is agreed that the correct amounts of non-taxable interest to be taken into consideration in computations of statutory net losses are $510.61 for 1923 and $637.54 for 1924, respectively.

69 OPINION

BLACK: In the recent case of Julia Stow Lovejoy (18 B. T. A. 1179) we held that fees, commissions, and expenses in obtaining a loan on mortgage were in the nature of capital expenditures and were not deductible in full in the year when paid or incurred, but should be spread proportionately over the term of the mortgage. That case is controlling here and the contention of petitioner that the mortgage fees should be deducted in the year when paid is denied in so far as such mortgage fees were paid in securing loans extending beyond the period of one year.

But the further question arises in this proceeding: How should the unamortized portion of these mortgage fees be treated in the year when the mortgaged property is sold and the mortgage is assumed by the purchaser? Should such unamortized portion of such fees be fully charged off in the year in which the sale is made, or should it at the time of sale be added to the capital cost of the property and in that manner be recovered tax free by the seller in reducing his profits on the sale?

There would be no difference in either method so far as the taxpayer's net income is concerned, if the sale is one where all the profit must be reported in the year of sale; but if the transaction is an installment sale under the statute, so that the period of reporting the profit on the sale may be spread over a period of years, then the practical effect of including unamortized mortgage fees as a capital adjustment is to spread the deduction over the period during
70 which the taxpayer is receiving the deferred payments and reporting the income from them. Now which is the correct method? The commissioner contends that the unamortized mort-

gage fees should be added to the cost of the property and in that way be recovered tax free by the seller in the sale.

Mortgage fees paid to secure a loan such as those involved in this proceeding do not represent cost of porperty but represent cost of the use of money borrowed. The purposes of the loans involved in this proceeding were to pay off existing mortgages on properties, to pay current obligations in the form of notes and open accounts to contractors for construction work, to purchase additional properties, and to pay general operating expenses of the company. The cash received from those loans was merged with other cash received from rental income, sale of properties, and other sundry income and out of the entire cash funds withdrawals were made from time to time for the above-mentioned purposes. Under such circumstances we think it would be altogether improper to say that the mortgage fees paid to secure such loans represented a part of the cost of the property mortgaged.

If A owns an apartment house worth $100,000 and needs some money and borrows $50,000 due in ten years and puts his apartment house up as security, and in addition to the regular rate of interest pays a $5,000 mortgage fee to get the money, under such circumstances we have held that he can not take the $5,000 as a de-
71 duction in the year that the loan is made and the mortgage fee is paid but the deduction must be spread over the life of the loan. (Cf. Chicago, Rock Island and Pacific R. R. Co., 13 B. T. A. 988; U. S. Playing Card Co., 15 B. T. A. 975.) But when A comes to sell his apartment house the year following the year in which the loan was made and the purchaser agrees to assume the mortgage, A does not add the $5,000 mortgage fee to the cost of his house. It has nothing to do with the cost of his house. He, having shifted the burden of his mortgage to other shoulders, stands in the same situation as if he had paid it off and therefore should be allowed to deduct the remaining portion of his unamortized mortgage fees.

In the instant case it is shown by stipulation of the parties that the petitioner accrued those items of mortgage fees on its books as "prepaid raising mortgage expense" and capitalized them thus and amortized them by way of deductions from income at rates which were properly related to the length of the loan.

It is further shown by stipulation of the parties that in the case of sale of any of the mortgaged property, the unamortized portion of the mortgage fees relating thereto was written off at the time of such sale. We think that is the proper accounting method and the commissioner should use it in computing the net income of the taxpayer for the respective years involved in this proceeding.

Petitioner alleges that respondent erred in his computation
72 of profit on the installment sale basis on the two properties located at 82nd Street and Broadway, and at 83rd Street and Broadway, and relies on the case of Schneider, Trustee of Bagby-Howe Drug Co., v. Lucas, decided August 3, 1929, Western District of Kentucky. This board, in Pachoco Creek Orchard Co. (12

B. T. A. 1358) and Dalraida Realty Co. (5 B. T. A. 905), had before it the construction of section 212 (d) of the revenue act of 1926, and regulations 69, articles 42–46, made in pursuance thereof, and we there held that the total contract price is the consideration named in the original agreement less the mortgage on the property, and that the sum thus found is to be used as the basis for the computation of percentage of profit. We think that is a correct interpretation of the statute, and we approve the action of the commissioner in so treating it.

Relative to the claim for deduction of the sum of $3,336.81 from income for 1924, petitioner claims that this item should properly have been included in its income for 1922 and should therefore be excluded from income for 1924. It claims that this was an error or neglect of its own accounting and should now be corrected.

It returned this sum as income for 1924, and it was so accepted by the respondent. It has not been shown that this was erroneous or unfair or that it did not clearly reflect petitioner's income. As petitioner made its return on the basis of its own system of accounting, we are of opinion that the respondent was correct in not eliminating this item. A similar principle was involved in
73 Charleston & Western Carolina Railway Co. (17 B. T. A. 569), where the railway company had accrued wages in one year, and which when unclaimed were subsequently credited to profit and loss in a later year, it was held to constitute income in the year when credited to profit and loss.

Reviewed by the board.

Judgment will be entered under rule 50.

A true copy. Teste:

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Now, March 7, 1931, the foregoing findings of fact & opinion certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

74 Before United States Board of Tax Appeals

Docket No. 36950

S. AND L. BUILDING CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

In pursuance of findings of fact and opinion promulgated in this proceeding on April 30, 1930, the respondent on June 17, 1930, filed his determination of the tax in words and figures as follows:

Calendar years:	Deficiency in tax
1924	None.
1925	$29,645.85

1924			Deficiency in tax
Net income as shown in the sixty-day letter dated February 4, 1928			$7,682.81
Adjustment allowed by the board:			
Mortgage fees allowed in the sixty-day letter	$101,533.75		
Mortgage fees agreed to (see board's decision)	127,876.75		26,343.00
Loss			$18,660.19
Tax liability			None.
Tax assessed			None.
Deficiency			None.

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1925			
Net income reported in the sixty-day letter			$261,133.74
Less:			
Additional mortgage fees allowed by board—			
Correct mortgage fees deductible		$264,692.33	
Mortgage fees deducted on return	$103,142.33		
Additional allowed in sixty-day letter	146,483.92	249,626.25	15,066.08
			$246,067.66
Less 1924 loss		$18,660.19	
Less 1924 nontaxable interest		637.54	18,022.65
Adjusted net income			$228,045.01
Amount of tax at 13%			$29,645.85
Tax assessed			None.
Deficiency in tax			$29,645.85

Petitioner contested the correctness of the above determination filed by the respondent in so far as it affects the year 1925, and on July 17, 1930, he filed his proposed alternative recomputation as follows:

"The commissioner, in his proposed redetermination of the deficiency covering the years 1924 and 1925, erred in applying
76 the board's decision promulgated April 30th, 1930, to the facts relating to the computation of profit in the year 1925 on the sale of 83rd Street and Broadway property, reported on the installment plan.

"Exception is taken only to the recomputation of deficiency for the year 1925. The commissioner, for the year 1925, determines the adjusted net income to be $228,045.01, arrived at by including therein $379,967.00 as profit realized in the year 1925 on the sale of 83rd Street and Broadway property computed on the installment basis. Petitioner contends that the correct method of computing profit realized on the sale of 83rd Street and Broadway property on the installment plan, as decided by the board in this case and in the Delraida Realty Co. (5 B. T. A. 905), is as follows (for figures presented here, see stipulation of facts, pages 7 and 8 and 10):

Original agreed consideration		$2,165,000.00
Less mortgages assumed		1,600,000.00
Total contract price (as the basis for computation of the percentage of total profit) determined by the board		$565,000.00

Total profit:		
Purchase price	$2,165,000.00	
Less net cost	1,522,033.00	$642,967.00
Percentage of total contract price to total profit		113.8%
77 Installment payments actually received in taxable year 1925:		
Initial payment	$300,000.00	
Installment on purchase money received	2,000.00	
Total		302,000.00
Reportable income, 1925: The correct amount of income to be returned in the year 1925 equals that proportion of the instalment payments actually received in the year 1925 which the total profit realized, or to be realized when the payment is completed, bears to the total contract price.		
Reportable income therefore equals 113.8%×$302,000.00		343,676.00
Commissioner determines the reportable profit to be		$379,967.00
The correct profit determined, as above		343,676.00
Excess profit reported by commissioner on 83rd Street and Broadway property for 1925		$36,291.00
Computation of tax:		
Adjusted net income, reported by commissioner (see page 2 of proposed redetermination) for 1925		$228,045.01
Less adjustment by petitioner of profit on sale of 83rd Street and Broadway property—		
78 Reported by Commissioner	$379,967.00	
Correct amount to be reported	343,676.00	
Total		$36,291.00
Corrected net income		$191,754.01
Correct amount of tax at 13%		$24,928.02
Amount computed by commissioner		29,645.85
Excess amount of tax computed by commissioner		$4,717.83 "

The final determination as proposed by the respondent and petitioner's alternative recomputation came on for hearing July 30, 1930, and after hearing the argument of counsel and carefully studying each of the proposed recomputations of tax, it appears that the only difference between the parties is as to the realized profit in 1925 from the sale of certain premises located at 83rd Street and Broadway. Respondent computed the realized profit from this transaction for the year 1925 to be $379,967 and petitioner computed the realized profits on such transaction for the purpose of arriving at the tax to be $343,676. The question is which of the two computations, if either, complies with the findings of fact and opinion promulgated by this board April 30, 1930.

79 A reading of the findings of fact and opinion promulgated by the board on April 30, 1930, in this proceeding will show that on page 8 and 9 of the findings of fact, we said:

" In computing the deficiencies the respondent included in the petitioner's income for the year 1925 profits realized on the sale during

the year 1925 of said property at 83rd Street and Broadway in the amount of $379,967 computed on the installment basis as follows:

Profit to be realized	$642,967.00
Contract price (without adjustment on account of excess of mortgages assumed over the basis)	565,000.00
Percentage of profit	100% plus
Initial payment	300,000.00
Installments received on purchase-money mortgage	2,000.00
Liability on bond and mortgage cancelled (being the excess of the mortgages assumed over the basis of the property to the taxpayer)	77,967.00
Profit to be reported, 1925	379,967.00"

On page 13 of the opinion we held that the total contract price is the consideration named in the original agreement less the mortgage assumed on the property and that the sum thus found is to be used as the basis for the computation of the percentage of profit. We said: "We think that is the correct interpretation of the stat-
80 ute and we have approved the action of the commissioner in so treating it." It is plain to our minds that the above quoted language of the opinion approved the computation of the realized profit on the sale of the property located at 83rd Street and Broadway as treated by the respondent in the deficiency letter and detailed on pages 8 and 9 of our findings of fact. It appears that in the final determination now submitted by the respondent that he treats the income received from the sale of this property located at 83rd Street and Broadway in the same way as he treated it in the original deficiency letter.

The respondent's determination of the tax filed herein June 17, 1930, is therefore held to be in accordance with the findings of fact and opinion promulgated in this proceeding April 30, 1930, and is therefore approved.

Ordered and decided: There is no deficiency for 1924; there is a deficiency in the tax against petitioner for the year 1925 of $29,645.85.

(Signed) EUGENE BLACK,
Member, United States Board of Tax Appeals.

Enter.

A true copy. Teste:

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Now, March 7, 1931, the foregoing order certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

81 In United States Circuit Court of Appeals for the Second Circuit

No. 36950. Term

S. & L. Building Corporation, petitioner

v.

David H. Blair, Commissioner of Internal Revenue, respondent

Petition for review

Filed Feb. 18, 1931

To the Honorable the Judges of the United States Circuit Court of Appeals for the Second Circuit:

The S. & L. Building Corporation, a corporation duly organized under the laws of the State of New York, with its principal place of business in the city of New York, in support of this, its petition for review of the decision of the United States Board of Tax Appeals entered September 16th, 1930, finally determining a deficiency in income tax of the petitioner for the calendar year 1925 in the amount of $29,645.85, respectfully shows to this honorable court, as follows:

I

STATEMENT OF NATURE OF CONTROVERSY

82 1. That on February 4th, 1928, David H. Blair, Commissioner of Internal Revenue, respondent above named, pursuant to section 274 of the revenue act of 1926, advised the S. & L. Building Corporation, petitioner above named, that a deficiency of $34,342.08 for the years 1924 and 1925 was determined.

Thereafter, on April 2nd, 1928, petitioner duly filed with the United States Board of Tax Appeals its petition requesting a redetermination of said deficiency of $34,342.08 covering the years 1924 and 1925.

After several motions were made by the Commissioner of Internal Revenue for extension of time to file his answer, said answer was filed on April 2nd, 1929. Thereafter the case was tried February 3rd, 1930, at which time amendments to the petition were proposed by petitioner. With the consent of counsel for the commissioner, and by order of the board, an amended petition was filed by petitioner February 11, 1930. Thereafter, on February 20th, 1930, an answer to the amended petition was filed by the Commissioner of Internal Revenue.

That the amended petition under items (E) and (F) alleged as follows:

"(E) That the commissioner incorrectly computed taxable profit on Broadway & 83rd Street property, sold in the year 1925, by his failure to properly apply the installment sales provision of the law.

(F) That the commissioner incorrectly computed taxable profit on Broadway & 82nd Street property, sold in the year 1924, by his failure to properly apply the installment sales division of the law."

83 2. Thereafter, on April 30th, 1930, the United States Board of Tax Appeals rendered its decision and entered judgment pursuant to rule 50 of the rules of practice, before the United States Board of Tax Appeals. That the findings of fact embodied in this decision promulgated April 30th, 1930, pertinent to the issue raised in this appeal are as follows:

"During the year 1924, the petitioner sold and disposed of premises 82nd Street & Broadway. The sales price was $2,100,000.00 made up as follows:

Cash	$300,000.00
First mortgage assumed	1,100,000 00
Purchase-money mortgage given by purchaser	700,000.00
Total	$2,100,000.00

"Said property was acquired by taxpayer after March 1st, 1913. Its depreciated cost at the time of the sale was $1,541,323.48, leaving a profit to be reported in the amount of $558,676.52."

"In addition to the cash of $30 000.00 received at the time of sale, the taxpayer received during the year 1924 the amount of $30,000.00 as installments on purchase money mortgage. During the year 1925, the petitioner received payments on said purchase money mortgage in the amount of $36,250.00. That the mortgage of $1,100,-

84 000.00 assumed by the purchaser provided that the principal sum thereof was payable in installments of $22,000.00 on December 1, 1924, and $22,000.00 every six months thereafter until April 9th, 1933, when the entire balance should become due and payable. In accordance with the agreement of sale, the purchaser paid to the holders of said mortgage in 1924 the amount of $22,000.00 and in 1925 the amount of $44,000.00."

"In determining the deficiencies the respondent included in the petitioner's income for the year 1924 the realized profit on the sale of property at Broadway & 82nd Street in the amount of $184,363.25 computed on the installment basis as follows:

Profit to be realized	$558,676.52
Contract price	1,000,000.00
Percentage of profit	55.867652%
Cash payment plus installment received on purchase-money mortgage	330,000.00
55.867652% times $330,000.00 equals	184,363.25

"That during the year 1925 the petitioner sold and disposed of the premises at 83rd Street and Broadway. The sales price was $2,165,000.00 made up as follows:

Cash	$300,000.00
First mortgage assumed	1,100,000.00
Second mortgage assumed	500,000.00
Purchase-money mortgage given by purchaser	265,000.00
Total	$2,165,000.00

85 "Said property was acquired by the taxpayer, after March 1st, 1913. Its depreciated cost at the time of sale was $1,522,033.00 leaving a profit to be reported in the amount of $642,967.00."

"In addition to the casl. payment of $300,000.00 the petitioner received on the purchase money mortgage during the year 1925 the sum of $2,000.00. That the loan secured by the first mortgage on said property in the amount of $1,100,000.00 was obtained by the petitioner in the year 1924; the terms thereof provide that the principal sum should be payable in installments of $16,500.00 payable May 1, 1926, and $16,500.00 every six months thereafter, until April 9, 1933, when the entire balance should become due and payable. The loan secured by the second mortgage on the said property in the amount of $500,000.00 was obtained by the petitioner during the year 1924, and provided that the principal sum should be payable in installments of $7,500.00 on May 7th, 1925, and $7,500.00 every three months thereafter until November 7th, 1934, when the entire balance should become due and payable. In the year 1925, the purchaser paid to the holders of the second mortgage the amount of $22,500.00 in respect to said installments."

"That in computing the deficiencies the respondent included in the petitioner's income for the year 1925, profits realized on the sale during the year 1925 of said property of Broadway & 83rd
86 Street in the amount of $379,967.00 computed on the installment basis as follows:

Profit to be realized	$642,967.00
Contract price (without adjustment on account of excess of mortgages assumed over the basis)	565,000.00
Percentage of profit	100% plus.
Initial payment	$300,000.00
Installments received on purchase-money mortgage	2,000.00
Liability on bond and mortgage cancelled (being the excess of mortgages assumed over the basis of the property to the taxpayer)	77,967.00
Profit to be reported in 1925	379,967.00"

3. That the United States Board of Tax Appeals, in its decision promulgated April 30th, 1930, rendered its opinion relative to the issue raised herein, as follows:

"Petitioner alleges that respondent erred in his computation of profit on the installment-sale basis in the two properties located at 82nd Street & Broadway and at 83rd Street & Broadway and relies on the case of Schneider, Trustee of Bagby-Howe Drug Co., v. Lucas, decided August 3, 1929, Western District of Kentucky.
87 This board, in Pacheco Creek Orchard Co. (12 B. T. A. 1358) and Dalraida Realty Co. (5 B. T. A. 905) had before it the construction of section 212 (d) of the revenue act of 1926, and regulations 69, articles 42–46, made in pursuance thereof, and we there held that the total contract price is in the consideration named in the original agreement less the mortgage on the property, and that the sum thus found is to be used as the basis for the computation of percentage of profit. We think that is a correct interpretation of

the statute, and we approve the action of the commissioner in so treating it."

4. Thereafter, on June 17th, 1930, the Commissioner of Internal Revenue filed with the United States Board of Tax Appeals proposed redetermination and notice of settlement pursuant to rule 50 of the rules of practice, before the United States Board of Tax Appeals. Prior to the date set for hearing, July 30th, 1930, the petitioner on July 16th, 1930, filed with the board notice of objection to proposed redetermination and alternative recomputation setting forth the board's method of computation on the sale of 83rd Street & Broadway property reported on the installment plan.

Thereafter, on July 30th, 1930, final hearing was held before the board. Thereafter the board issued its order of final determination of tax approving respondent's determination filed June 17th, 1930. On September 16th, 1930, the order of final determination of tax was entered by the United States Board of Tax Appeals.

88 This order determined there is no deficiency for the year 1924; there is a deficiency in tax for the year 1925 of $29,645.85.

II

DESIGNATION OF COURT OF REVIEW

The petitioner being aggrieved by the said opinion, decision, and order, desires a review thereof by the United States Circuit Court of Appeals for the Second Circuit within which circuit is located the office of the collector of internal revenue to whom said petitioner made its income-tax returns.

III

ASSIGNMENT OF ERRORS

The petitioner makes the following assignment of errors:

1. That the board erred in holding, in the case of sale of real estate reported on the installment plan, where the purchaser assumed the unpaid mortgage loans which were originally obtained by the petitioner, that the "total contract price" to be used as the basis for the computation of percentage of profit is the consideration named in the original agreement less the mortgage on the property.

2. The Board erred in approving the commissioner's computation

89 of initial payment on 82nd St. & Broadway and 83rd St. & Broadway properties reported on the installment plan.

3. The board erred in approving the commissioner's computation of profits on the sale in the year 1925 of property at 83rd Street & Broadway reported on the installment plan, by including in said profits to be reported in the year 1925 an item representing the excess of mortgages assumed over the basis of the property to the taxpayer.

Wherefore, your petitioner prays that this honorable court may review said decision, opinion, and order, and reverse and set aside the same and that the clerk of the said United States Board of Tax Appeals be directed to transmit and deliver to the clerk of said court certified copies of all and every of the documents necessary and material to the presentation and consideration of the foregoing petition for review and as required by the rules of said court, statutes made and provided. And your petitioner will ever pray.

S. & L. BUILDING CORPORATION,
By SAM MINSKOFF, *President.*

GEORGE W. PERPER,
Attorney for Petitioner.
Office & P. O. address, 11 West 42nd Street, Manhattan Borough, New York City.

90 [*Duly sworn to by Sam Minskoff; jurat omitted in printing.*]

Now, March 7, 1931, the foregoing petition for review certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

91 Before United States Board of Tax Appeals

[Title omitted.]

Præcipe

Filed Feb. 18, 1931

To the Clerk of the United States Board of Tax Appeals:

You will please prepare and, within sixty days from the date of the filing of the petition for the review in the above-stated case, transmit to the clerk of the United States Circuit Court of Appeals for the Second Circuit certified copies of the following documents:

1. The docket entries of proceedings before the United States Board of Tax Appeals in the case above entitled.
2. Pleadings before the board.
3. Findings of fact, opinion, and decision of the board.
4. Petition for review.

92 The foregoing to be prepared, certified, and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Second Circuit.

GEORGE W. PERPER,
Attorney for S. & L. Building Corporation.

Dated, Feb. 18, 1931.

George W. Perper, attorney for S. & L. Building Corp., 11 West 42nd Street, New York, N. Y.

Now, March 7, 1931, the foregoing præcipe cert'fied from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

(3503)

93 In United States Circuit Court of Appeals for the Second Circuit

No. 41, October term, 1931

Argued May 16, 1932. Decided July 18, 1932

S. & L. BUILDING CORPORATION, APPELLANT

v.

COMMISSIONER OF INTERNAL REVENUE, APPELLEE

Appeal from the United States Board of Tax Appeals

Before L. HAND, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

Appeal by the petitioner from an order of the Board of Tax Appeals, fixing a deficiency upon its income tax for the year 1925.

Leo H. Hoffman, of New York City, for appellant.

Andrew D. Sharpe, of Washington, D. C., for appellee.

Opinion

L. HAND, Circuit Judge:

The appeal involves the application of section 212 (d) of the revenue act of 1926 (26 U.S.C.A., § 953 (d)), which, although the transactions at bar happened in 1924 and 1925, section 1208 of the act (26 U.S.C.A., § 953a) made retroactive. It was designed to allow a taxpayer in the case of installment sales to spread the profit over the whole period during which payments were made, so as to avoid loading all of it upon those years which followed the amortization of the original cost. It gave a privilege; "the income may * * * be returned on the basis and in the manner above prescribed."

The petitioner had two parcels of realty in New York, each bought after March 1, 1913. It sold one in 1924, the other in 1925. It had previously placed one mortgage upon the first parcel, two upon the second. Each buyer paid a sum down, executed a purchase-money mortgage and assumed the payment of the existing mortgages. The petitioner chose to treat the sales as falling within section 212 (d), and the commissioner agreed; they differed as to how the tax should be calculated. Both found the profit by subtracting the depreciated cost, the "base," from the sum of the cash to be paid and the face of all the mortgages. The petitioner returned in both years that part of the profit calculated as follows: It added together the cash

actually paid and all payments made on any of the mortgages; this sum it considered "instalment payments actually received in that year." It applied to this amount a fraction of which the profit was the numerator, and the denominator was the sum of the cash to be paid and the face of all the mortgages. The commissioner took as the "installment payments actually received," the cash paid in any year, and all payments made upon the purchase-money mortgage; he excluded payments on the mortgages assumed. For the numerator of the fraction, like the petitioner he took the profit; but for the denominator he took the sum of the cash to be paid and the face of the purchase-money mortgage, excluding those assumed. In so doing he followed his regulation, made by virtue of the power given him by section 212 (d); regulations 69, article 44. Thus the differences between the parties arise first as to what should be considered the "installment payments actually received in that year," and second, as to what was "the total contract price." In general, the difference is whether the assumed mortgages shall be included in both factors.

The regulation in refusing to allow the payment of the assumed mortgages as "installments actually received," apparently con-
94 sidered the money borrowed as the seller's reimbursement pro tanto of the "base." The discharge of the loan is not therefore a receipt on the purchase price; money paid to his use is not "received" by him. No one can deny that this is the more natural sense to impose upon the phrase; a man does not "actually receive" what is paid to another. Yet in cases where the assumed mortgages exceed the "base," the regulation charges the seller with the whole excess at once. The sale at bar in 1925 was such a case. The regulation is inconsistent in these dispositions. If, when the assumed mortgages do not exceed the "base," payments are not "received" by the taxpayer, he can "receive" none, when they do. Indeed, the regu.ation goes even further; it makes the mere assumption an "installment actually received." No doubt, the excess must at some time be counted as profit; and it cannot be returned as of the time the money was borrowed, for the transaction is not then closed. There appears to be no intelligible way of dealing with it but to hold that the profit is received when the installments are paid. But if so, the same must be true when there is no excess.

Again, the regulation involves an equivocal use of the phrase, "total contract price." Obviously the denominator of the fraction to be applied to each "installment actually received," must be the sum of all such installments. If it be larger, the whole profit will never be covered. For this reason the regulation, which does not include among installments payments upon the assumed mortgages, excludes their face from the denominator. Yet in calculating the profit it necessarily includes the mortgages in the minuend, else there would ordinarily never be any profit. But the section, which necessarily implies that profit shall be reckoned by using a price which includes all the mortgages, can not mean something else when speaking of

the denominator of the fraction. In defining the condition upon the privilege in the case of realty it uses the phrase, "purchase price," but that has nothing to do with the question here; it touches not the calculation of the income to be returned but the right to spread the profit at all. Nevertheless, it is extremely improbable that it means anything else than "total contract price," and the commissioner here agrees that it includes assumed mortgages.

Thus it is apparent that no theory can be consistently applied which does no violence to the text; the fact is that the section was drawn without this situation in mind. It followed the lines of earlier regulations beginning with 1916, none of which had themselves dealt with the case of assumed mortgages. We of course agree that in such a situation the powers of the commissioner must be given wide latitude, especially perhaps, because the very section contains an express grant. But though he may impose any reasonable interpretation upon the language, and we should accept it, even though we independently thought otherwise, his gloss must be consistent; he may not read the same words in one sense in one connection and differently in another. We can see no escape from treating the phrase "installments actually received" as including payments made to the seller's use. Nor does this do great violence to the words. Though the seller has already received the money, he must repay it. The funds are his, to be sure; he may use them; but he is bound for their equivalent and it is not merely a figure of speech to regard his final quittance as that which assures their receipt. True, this may result in imposing a tax after direct payments have ended, and that would be unfair, if it was compulsory; but it is not, for the section merely gives an option, and the taxpayer may not object to what he can avoid.

We can not see that Lucas v. Schneider (47 F.(2d) 1006 (C. C. A. 6)) has any bearing on the situation here. The ruling would indeed deprive the petitioner of any recourse to the section at all, which the commissioner does not assert. As applied to the sale in 1925, it would also require us to treat the excess of the assumed mortgages over the "base" as "property" received at once. But we could scarcely stop there; we should be obliged to treat the whole of the assumed mortgages in the same way, and that would suit neither party. In any case Judge Denison seems to us to have been right in saying that the assumption of a mortgage is not "property" but "evidence of indebtedness." However that may be, we need here only decide whether the regulation is a correct interpretation of the statute as to the calculation of the return. We think that it is not, and that the petitioner is right in its insistence that payments reducing the assumed mortgages are to be included among "installments actually received." The rest follows.

Order reversed; cause remanded for further proceedings in accordance with the foregoing.

95 In United States Circuit Court of Appeals, Second Circuit

At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the court rooms in the Post Office Building in the city of New York, on the 25th day of July, one thousand nine hundred and thirty-two.

Present: Hon. Learned Hand, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges.

S. & L. BUILDING CORPORATION, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Filed July 26, 1932

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be, and it hereby is, reversed and cause remanded for further proceedings in accordance with the opinion of this court.

It is further ordered that a mandate issue to the said board in accordance with this decree.

WM. PARKIN, *Clerk.*

96 [File endorsement omitted.]

97 [Clerk's certificate to foregoing transcript omitted in printing.]

98 Supreme Court of the United States

Order allowing certiorari

Filed December 5, 1932

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 37172. U. S. Circuit Court of Appeals, Second Circuit. Term No. 475. David Burnet, Commissioner of Internal Revenue, petitioner, vs. S. & L. Building Corporation. Petition for a writ of certiorari and exhibit thereto. Filed October 25, 1932. File No. 37172.

U. S. GOVERNMENT PRINTING OFFICE: 1933

FILED
OCT 25 1932
CHARLES ELMORE CROPLEY
CLERK

FILE COPY

No. 475

In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

S. & L. BUILDING CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. ——

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

S. & L. BUILDING CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of David Burnet, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit, entered in the above cause on July 25, 1932, reversing the decision of the Board of Tax Appeals.

QUESTION PRESENTED

Whether the first sentence of the last paragraph of Article 44 of Treasury Regulations 69, as amended, pp. 16–17, *infra*, is a valid regulation.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, pp. 15–17, *infra*.

STATEMENT

The facts material to the present issue, as found by the Board of Tax Appeals (R. 59–68), may be summarized as follows:

The respondent is a New York corporation engaged in the real estate business in New York City. During 1925 and prior years it obtained loans secured by mortgages upon its properties in order to finance its business. (R. 59–60.) It kept its books and made its income-tax returns upon the accrual basis. (R. 60.)

The respondent owned two pieces of property located, respectively, at 82nd Street and Broadway and 83rd Street and Broadway, which were acquired by it after March 1, 1913. The 82nd Street property was sold in 1924 for $2,100,000, of which $300,000 was paid in cash. For the balance of the purchase price the purchaser assumed a first mortgage of $1,100,000 and gave a purchase-money mortgage of $700,000. The depreciated cost of the property at the time of sale was $1,541,323.48, making a total profit on the sale of $558,676.52. In addition to the cash payment of $300,000, the respondent received installments on the purchase-money mortgage during 1924 in the amount of $30,000, and during 1925 in the amount of $36,250. During 1924 and 1925 the purchaser paid to the holders of

the first mortgage, in accordance with the terms of sale, $22,000 and $44,000, respectively, the first mortgage being payable in installments of $22,000 each, due every six months beginning December 1, 1924, until April 9, 1933, when the entire balance becomes due and payable. (R. 63–64.)

The 83rd Street property was sold in 1925 for $2,165,000, of which $300,000 was paid in cash. For the balance of the purchase price the purchaser assumed a first mortgage of $1,100,000 and a second mortgage of $500,000 and gave a purchase-money mortgage of $265,000. The depreciated cost of this property at the time of sale was $1,522,033, making a total profit on the sale of $642,967. In addition to the $300,000 cash payment, the respondent received in 1925 $2,000 upon the purchase-money mortgage. The first and second mortgages assumed by the purchaser exceeded the depreciated cost of the property to the respondent by the amount of $77,967. In 1925 the purchaser paid to the holders of the second mortgage the sum of $22,500. The first mortgage provided for payment in installments of $16,500 each, due May 1, 1926, and every six months thereafter until April 9, 1933, when the entire balance becomes due. The second mortgage provided for payment in installments of $7,500 each, due May 7, 1925, and every three months thereafter until November 7, 1934, when the entire balance becomes due. (R. 64–66.)

The Commissioner of Internal Revenue, in determining the respondent's tax liability for 1924 and

1925, computed the income from the sale of the two pieces of property on the installment basis. In computing the income upon such basis the Commissioner did not include as a part of the "initial payments" or of the "total contract" price the amount of the mortgages assumed by the purchasers. He included as part of the income received in 1925 from the sale of the 83rd Street property the amount by which the mortgages assumed exceeded the depreciated cost. By this method the Commissioner determined that the profit realized in 1924 on the sale of the 82nd Street property was $184,363.25, computed as follows (R. 66):

Profit to be realized	$558,676.52
Contract price	1,000,000.00
Percentage of profit to contract price	55.86752%
Cash payment plus installments received on purchase-money mortgage	330,000.00
55.86752% times $330,000 equals	184,363.25

Applying the same percentage to the installments of $36,250 received in 1925 on the purchase-money mortgage on the 82nd Street property, the Commissioner determined the realized profit for 1925 on that sale to be $20,252.02. (R. 66.)

By the same method the Commissioner determined a realized profit for 1925 on the sale of the 83rd Street property of $379,967, computed as follows (R. 67):

Profit to be realized	$642,967
Contract price	565,000
Percentage of profit to contract price	100% plus
Initial payment	300,000
Installments on purchase-money mortgage	2,000
Excess of mortgages assumed over depreciated cost of property	77,967
Profit realized in 1925	379,967

The Board of Tax Appeals approved the Commissioner's method of computing the profits realized in 1924 and 1925 from the sales of the 82nd Street and 83rd Street properties[1] (R. 71–72), but upon appeal the Circuit Court of Appeals reversed the decision of the Board, the court holding that Article 44 of Regulations 69, upon which the Commissioner based his computations, was not a proper interpretation of the statute (R. —).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred: 1. In holding that Regulations 69, Article 44, in so far as it relates to the manner of computing income from the sale of real estate upon the installment basis, is invalid.

2. In not holding that Article 44, Regulations 69, is valid and in not applying the method of computation therein prescribed.

REASONS FOR GRANTING THE WRIT

1. The decision of the Circuit Court of Appeals that Article 44 of Regulations 69, so far as it is applicable to the instant case, is invalid conflicts in principle with the decision of the Circuit Court of

[1] The Commissioner had determined deficiencies of $394.69 and $33,947.39 for 1924 and 1925, respectively. (R. 12, 35.) Although the Board sustained the Commissioner with respect to the issues raised in this petition, its determination in favor of the taxpayer of other issues, not here involved, resulted in an order of no deficiency for 1924 and a deficiency of $29,645.85 for 1925. (R. 74–80.)

Appeals for the Sixth Circuit in *Lucas* v. *Schneider*, 47 F. (2d) 1006, certiorari denied, 284 U. S. 622, wherein the same regulation was held valid. The resulting uncertainty as to the validity of the regulation has caused confusion in the administration of the applicable statute.

2. The question decided by the Circuit Court of Appeals is of importance in the administration of the tax laws. The provisions of the regulation in question were made retroactive for all years beginning with 1916, and substantially identical provisions are contained in Regulations 74, issued under the 1928 Act. A large number of returns have been audited on the basis of the regulation, the application of which has been uniformly sustained by the Board of Tax Appeals. The decision of the court below, if permitted to stand, will result in the filing of numerous refund claims and suits and in the reopening of many cases already audited, as well as in the raising of new issues and the assertion of increased deficiencies in cases now pending before the Board.

3. The decision of the Circuit Court of Appeals establishes a method of computing income in connection with the sale of real estate upon the installment basis which is inconsistent with the general scheme of accounting contemplated by the Revenue Acts and is impracticable of administration, since it requires both taxpayers and the Bureau of Internal Revenue to determine income

not by reference to the taxpayers' own books and records, but by making collateral inquiries each year with regard to the amount of payments received by the various holders of assumed mortgage obligations.

Wherefore it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

OCTOBER, 1932.

144218—32——2

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. —) is reported in — F. (2d) —. The findings of fact and opinion of the Board of Tax Appeals (R. 57–73) are reported in 19 B. T. A. 788.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 25, 1932. (R. —.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED, STATUTES INVOLVED, ETC.

The question presented, specification of errors to be urged, and a statement of the case will be found in the petition. The statutes and regulations involved will be found in the Appendix, pp. 15–17, *infra*.

ARGUMENT

The Circuit Court of Appeals held that in computing the annual realized profit from the sale of real estate on the installment basis, as permitted by Section 212 (d) of the Revenue Act of 1926, pp. 15–16, *infra*, the "installment payments actually received" must include payments by the purchaser to the holders of existing mortgages, assumed as part of the purchase price, as well as all payments to the seller, and that the amount of such assumed mortgages, as well as cash payments and purchase-

money mortgages given, must be included in "the total contract price," which is the determining factor in arriving at the proportion of annual receipts to be reported as realized income. The rule thus laid down is directly contrary to Article 44 of Treasury Regulations 69, pp. 16–17, *infra.*

Section 212 (d) authorizes the return upon the installment basis, under regulations prescribed by the Treasury Department, of income from a sale of real estate where the "initial payments" do not exceed one-fourth the "purchase price." The statute provides that the taxpayer may return as income from such a sale that proportion of "the installment payments actually received" in the taxable year, "which the total profit realized or to be realized when the payment is completed bears to the total contract price." Quite obviously Section 212 (d) provides only for the simple and usual case of sales of property upon the installment plan and designates the method to be used in determining annual income therefrom. By that Section Congress did not undertake to prescribe meticulously the formula to be employed or to define the factors to be applied in all cases, especially the more complex sales of real property subject to existing mortgages.

Article 44, Regulations 69, adopted pursuant to express authority contained in Section 212 (d), provides that the amount of assumed existing mortgages shall be included in the "purchase price" but, to the extent they do not exceed the "basis" (for

determining gain or loss), they shall not be included as part of "the initial payments" or of "the total contract price." Under the rule thus prescribed the amount of assumed mortgages, while considered a part of the total consideration for the sale, is excluded from "the total contract price," which is taken to mean the aggregate payments to be received *by the seller alone.* Likewise, payments on the assumed mortgages are excluded from the "installment payments actually received," which latter phrase is taken to mean only installment payments received by the seller alone. The excess, if any, of the assumed mortgages over the "basis" is treated as income realized at the time liability is assumed by the purchaser.

The regulation, we believe, gives effect to the intent of the statute and is a correct interpretation of it. The purpose of the statute undoubtedly was to permit deferring the return for taxation of the realized gain on a completed transaction of the character described until the actual receipt of cash or its equivalent by the taxpayer. The regulation effectuates this purpose by treating as income a ratable amount of the payments actually received by the taxpayer alone, exclusive of any payments made to third persons as holders of mortgages assumed by the purchaser.

Inconsistency in the regulation suggested by the court below is more apparent than real. The excess of assumed mortgages over the "basis" is properly treated as realized income to the taxpayer

at the time of assumption of liability by the purchaser, for the taxpayer is, as between himself and the purchaser, then relieved of liability; and to the extent of such excess, theretofore received as a loan, the taxpayer has at that time derived income, under the principle of *United States* v. *Kirby Lumber Co.*, 284 U. S. 1. No inconsistency results from excluding the remainder of the assumed mortgages from the "total contract price" and the payments thereon from "installment payments actually received," for payments on such mortgages are not to be made to the taxpayer; and while counted in full as part of the total consideration for the sale, the assumption of the mortgages to the extent not in excess of the "basis" may properly be treated as a return of the "basis," and hence excluded from both factors of the ratio applicable in computing the amount of income realized by the taxpayer from each installment payment.

The decision below, we submit, does not conform to the statute and fails to give effect to its purpose. Under the construction adopted by the court, the terms "installment payments actually received" and "total contract price" bear no relation to receipts by the taxpayer (seller), but are measured by payments made by the purchaser to both the taxpayer and third persons, holders of the mortgages assumed. As a result the taxpayer may be required to report income in a year in which he has received nothing and even in years long after he has received all payments due him. Such a result is inconsist-

ent with the general scheme of accounting contemplated by the Revenue Acts and measures the tax payer's income, to some extent at least, by the receipts of another. This, it is believed, was not contemplated by Congress, which must have intended apportioning only the payments received by the taxpayer. If, as the Circuit Court of Appeals holds, the assumed mortgages must be included in the "total contract price," consistency requires that the amount thereof also be included in the "initial payments." In that event, the initial payments in each sale here involved would exceed one-fourth the purchase price, as will be true in practically all such cases, so that the benefit of the installment basis of reporting income conferred by the statute could not be claimed by the respondent.

Moreover, the decision of the court below presents great difficulties of administration. Under that decision it is necessary to take account of the payments made by the purchaser in each year, not only to the taxpayer but also to the holders of the mortgages, which latter payments are not necessarily reflected on the taxpayer's books. The obstacles thus confronting the Treasury Department in the proper audit of the returns of the taxpayer and in the assessment and collection of taxes are obvious. These obstacles are even more serious in the event of subsequent transfers of the mortgages and of the property by successive purchasers.

The decision of the court below is in conflict in principle with *Lucas* v. *Schneider,* 47 F. (2d) 1006 (C. C. A. 6th), certiorari denied, 284 U. S. 622, in which case the court upheld the validity of the regulation which the court below held invalid. It was there held that the *excess* of the assumed mortgages over the "basis" should be included in the "initial payments," excluding the remainder of such mortgages, as provided by the regulations. In that case the initial payments computed in accordance with the regulations exceeded one-fourth of the purchase price, and it was held that the income could not be reported on the installment basis.

The regulation nullified by the decision of the court below has been consistently upheld by the Board of Tax Appeals. See *Appeal of Bosshardt,* 4 B. T. A. 1262; *Appeal of Dalriada Realty Co., Inc.,* 5 B. T. A. 905; *Pacheco Creek Orchard Co.* v. *Commissioner,* 12 B. T. A. 1358; *McWilliams* v. *Commissioner,* 15 B. T. A. 329; *Watson* v. *Commissioner,* 20 B. T. A. 270; *Fifty-three West Seventy-second Street, Inc.,* v. *Commissioner,* 23 B. T. A. 164; *Metropolitan Properties Corp.* v. *Commissioner,* 24 B. T. A. 220. Moreover, the statute to which the regulation applies was substantially reenacted in the Revenue Act of 1928, c. 852, sec. 44, 45 Stat. 791, 805, and in the Revenue Act of 1932, Section 44, Public No. 154. Regulations 74, Art. 352, applicable to the 1928 Act, repeat, so far as presently material, the regulations now in

question. Under these circumstances, the administrative interpretation of the statute should not be disregarded. See *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375; *Brewster* v. *Gage*, 280 U. S. 327, 337.

CONCLUSION

The decision of this Court is required to prevent confusion in the administration of the statute which the decision of the court below creates. Therefore, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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OCTOBER, 1932.

APPENDIX

STATUTES AND REGULATIONS

Revenue Act of 1926, c. 27, 44 Stat. 9, 23, 41, 130:

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. * * * (U. S. C. App., Title 26, Sec. 984.)

SEC. 212. (b) The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but * * * if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

(d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceed-

ing $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made. (U. S. C. App., Title 26, Sec. 953.)

SEC. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provisions of * * * the Revenue Act of 1924, * * *. (U. S. C. App., Title 26, Sec. 953 (a).)

Treasury Regulations 69:

ART. 44. *Sale of real property involving deferred payments.*—Under section 212 (d) deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed one-fourth of the purchase price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed one-fourth of the purchase price.

Sales falling within class (1) and class (2) alike include (a) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the purchase price has been paid, and (b) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the "purchase price," but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as a part of the "initial payments" or of the "total contract price," as those terms are used in section 212 (d), in articles 42 and 45, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the "initial payments," the "total contract price," or the "purchase price." (As amended by Treasury Decision 4255, approved January 8, 1929, Internal Revenue Cumulative Bulletin VIII–1, p. 165.)

ART. 45. *Sale of real property on installment plan.*—In transactions included in class (1) in article 44 the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price. * * *

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No. 475

In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

S. & L. BUILDING CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

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BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 42–44) is reported in 60 F. (2d) 719. The findings of fact and opinion of the Board of Tax Appeals (R. 26–33) are reported in 19 B. T. A. 788.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 26, 1932. (R. 45.) Petition for certiorari was filed on October 25, 1932 (R. 45), and granted December 5, 1932 (R. 45). Jurisdic-

tion is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether in computing the annual taxable income, upon the installment sales basis, from the sale of real estate subject to mortgages which are assumed by the purchaser, such mortgages not in excess of the basis to the seller (for determining gain or loss) should be excluded from the "total contract price" and the "initial payments" as provided in Article 44 of Treasury Regulations 69.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in the Appendix, pp. 24–26, *infra*.

STATEMENT

The facts material to the present issue, as found by the Board of Tax Appeals (R. 26–31), may be summarized as follows:

The respondent is a New York corporation engaged in the real estate business in New York City. During 1925 and prior years it obtained loans secured by mortgages upon its properties in order to finance its business. (R. 26.) It kept its books and made its income-tax returns upon the accrual basis. (R. 27.)

The respondent owned two pieces of property located, respectively, at 82nd Street and Broadway

and at 83rd Street and Broadway, which were acquired by it after March 1, 1913. The 82nd Street property was sold in 1924 for $2,100,000, of which $300,000 was paid in cash. For the balance of the purchase price the purchaser assumed a first mortgage of $1,100,000 and gave a purchase-money mortgage of $700,000. The depreciated cost of the property at the time of sale was $1,541,323.48, making a total profit on the sale of $558,676.52. In addition to the cash payment of $300,000, the respondent received installments on the purchase-money mortgage during 1924 in the amount of $30,000, and during 1925 in the amount of $36,250. During 1924 and 1925 the purchaser paid to the holders of the first mortgage, in accordance with the terms of sale, $22,000 and $44,000, respectively, the first mortgage being payable in installments of $22,000 each, due every six months beginning December 1, 1924, until April 9, 1933, when the entire balance becomes due and payable. (R. 28–29.)

The 83rd Street property was sold in 1925 for $2,165,000, of which $300,000 was paid in cash. For the balance of the purchase price the purchaser assumed a first mortgage of $1,100,000 and a second mortgage of $500,000 and gave a purchase-money mortgage of $265,000. The depreciated cost of this property at the time of sale was $1,522,033, making a total profit on the sale of $642,967. In addition to the $300,000 cash payment, the respondent received in 1925 $2,000 upon the purchase-money mortgage. The first and second mortgages as-

sumed by the purchaser exceeded the depreciated cost of the property to the respondent by the amount of $77,967. In 1925 the purchaser paid to the holders of the second mortgage the sum of $22,500. The first mortgage provided for payment in installments of $16,500 each, due May 1, 1926, and every six months thereafter until April 9, 1933, when the entire balance becomes due. The second mortgage provided for payment in installments of $7,500 each, due May 7, 1925, and every three months thereafter until November 7, 1934, when the entire balance becomes due. (R. 29–30.)

The Commissioner of Internal Revenue, in determining the respondent's tax liability for 1924 and 1925, computed the income from the sale of the two pieces of property on the installment basis. In computing the income upon such basis the Commissioner did not include as a part of the "initial payments" or of the "total contract price" the amount of the mortgages assumed by the purchasers. He included as part of the income received in 1925 from the sale of the 83rd Street property the amount by which the mortgages assumed exceeded the depreciated cost. By this method the Commissioner determined that the profit realized in 1924 on the sale of the 82nd Street property was $184,363.25, computed as follows (R. 30):

Profit to be realized	$558,676.32
Contract price	1,000,000.00
Percentage of profit to contract price	55.867652%
Cash payment plus installments received on purchase-money mortgage	330,000.00
55.867652% times $330,000 equals	184,363.25

Applying the same percentage to the installments of $36,250 received in 1925 on the purchase-money mortgage on the 82nd Street property, the Commissioner determined the realized profit for 1925 on that sale to be $20,252.02. (R. 30.)

By the same method the Commissioner determined a realized profit for 1925 on the sale of the 83rd Street property of $379,967, computed as follows (R. 30):

Profit to be realized	$642,967
Contract price	565,000
Percentage of profit to contract price	100% plus.
Initial payment	300,000
Installments on purchase-money mortgage	2,000
Excess of mortgages assumed over depreciated cost of property	77,967
Profit realized in 1925	379,967

The respondent claims that the profits realized annually from the sales of the two properties should be computed upon the installment basis as follows (R. 13–14):

1924

82nd Street and Broadway property:		
Gross profit		$558,676.52
Total contract price (purchase price)		2,100,000.00
Installment payments for 1924—		
Cash received	$300,000.00	
Payments received on purchase-money mortgage	30,000.00	
Amount paid to holders of first mortgage assumed	22,000.00	
		352,000.00
Percentage of profit ($558,676.52÷$2,100,000)		.26603644
Profit applicable to 1924		$93,644.83

1925

Installment payments on 82nd St. and Broadway sale—		
Payments received on purchase-money mortgage	$36,250.00	
Amount paid to holders of first mortgage assumed	44,000.00	
		$80,250.00
Percentage of profit		.26603644
Profit applicable to 1925 (82nd St. and Broadway)		$21,349.42
83rd and Broadway property:		
Gross profit		$642,967.00
Total contract price (purchase price)		2,165,000.00
Installment payments received in 1925—		
Cash received	$300,000.00	
Payments received on purchase-money mortgage	2,000.00	
Amount paid to holders of second mortgage assumed	22,500.00	
		$324,500.00
Percentage of profit ($642,967÷$2,165,000.00)		.29698245
Profit applicable to 1925 (83rd St. and Broadway)		$96,370.80

The Board of Tax Appeals approved the Commissioner's method of computing the profits realized in 1924 and 1925 from the sales of the 82nd Street and 83rd Street properties [1] (R. 32–33), but upon appeal the Circuit Court of Appeals reversed the decision of the Board, the court holding that Article 44 of Regulations 69, upon which the Commissioner based his computations, was not a proper interpretation of the statute. The court approved

[1] The Commissioner had determined deficiencies of $394.69 and $33,947.39 for 1924 and 1925, respectively. (R. 5.) Although the Board sustained the Commissioner with respect to the issues raised in this petition, its determination in favor of the taxpayer of other issues, not here involved, resulted in an order of no deficiency for 1924 and a deficiency of $29,645.85 for 1925. (R. 36.)

the respondent's method of computing the profit realized annually from the sales. (R. 42–44.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Regulations 69, Article 44, in so far as it relates to the manner of computing income from the sale of real estate upon the installment basis, is invalid.

2. In not holding that Article 44, Regulations 69, is valid and in not applying the method of computation therein prescribed.

SUMMARY OF ARGUMENT

The statute authorizes the taxpayer to report as income in any year from the sale of real property on the installment plan that proportion of the "installment payments actually received" during the year which the total profit to be realized bears to the "total contract price." The purpose of the statute is to permit the taxpayer in such cases to defer reporting the gain as income until the actual receipt by the taxpayer of the cash or its equivalent. The statute prescribes the general formula to be applied, but does not undertake to define meticulously the factors to be used. The details essential to a proper application of the provisions of the statute to particular classes of cases were to be developed by regulations which the Commissioner was directed to adopt.

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Under the regulations adopted by the Commissioner the amount of mortgages assumed by the purchaser, not in excess of the basis of the property to the seller, is excluded from the "total contract price" as a factor in the ratio applicable in determining the profit received with each installment payment. Likewise, payments made by the purchaser to the holders of the mortgages assumed are excluded from the "installment payments actually received" to which the ratio is to be applied. To the extent, however, that the mortgages assumed exceed the basis to the seller, the amount thereof under the regulations is included in the seller's income for the year of sale, when by the assumption the taxpayer is relieved of primary liability.

The regulations limit the "total contract price" to the aggregate payments to be made to the taxpayer under the contract and the "installment payments" to actual receipts by the taxpayer. The regulations give effect to the clear purpose of the statute and having been adopted pursuant to express statutory authority they should be accorded the force and effect of law.

Under the ruling of the court below, holding the regulations invalid, there is no relation between the receipts by the taxpayer and the income chargeable to him, for by the method there sanctioned the taxpayer is charged with income measured to some extent at least by the receipts of another. The decision below is inconsistent with the general scheme

of the Revenue Acts and fails to give effect to the purpose of the statute in question.

ARGUMENT

IN COMPUTING ANNUAL INCOME FROM SALE OF REAL PROPERTY ON INSTALLMENT BASIS, MORTGAGES ASSUMED SHOULD BE EXCLUDED FROM "THE TOTAL CONTRACT PRICE" AND PAYMENTS THEREON TO MORTGAGEES SHOULD BE EXCLUDED FROM "INSTALLMENT PAYMENTS ACTUALLY RECEIVED" IN EACH YEAR BY THE TAXPAYER

There is no dispute as to the amount of profit accruing to respondent from sales of its realty in 1924 and 1925. The sole question is as to the time when it was realized and the manner in which it should be returned for income tax purposes.

Respondent makes its returns on the accrual basis (R. 27), and, except as otherwise permitted by statute, would be compelled to return its total profits as income in the years in which they accrued, that is, in the years the sales were made. See Revenue Act of 1924, c. 234, Sec. 212 (b), 43 Stat. 253, 267 (U. S. C., Title 26, Sec. 953); *American National Co.* v. *United States,* 274 U. S. 99; *United States* v. *Anderson,* 269 U. S. 422.

By Section 212 (d) of the Revenue Act of 1926, *infra,* the taxpayer is authorized to return, under regulations prescribed by the Treasury Department, income from the sale of real estate upon the installment basis, if the "initial payments" do not exceed one-fourth the "purchase price." It is provided that in such cases the taxpayer may return

as income each year that proportion of "the installment payments actually received" in the taxable year, "which the total profit realized or to be realized when the payment is completed, bears to the total contract price." Although the two sales here in question took place in 1924 and 1925, respectively, before enactment of the Revenue Act of 1926, Section 1208 of that Act, *infra,* provides that subdivision (d) of Section 212 shall be retroactively applied in computing income under the provisions of the 1924 Act.

The Revenue Acts prior to 1926 did not contain any express authority for reporting income on the installment basis, but the right to do so was contained in regulations promulgated by the Commissioner with the approval of the Secretary of the Treasury.[2] These regulations, however, were held unauthorized and invalid by the Board of Tax Appeals. *B. B. Todd, Inc.,* 1 B. T. A. 762; *H. B. Graves Co., Inc.,* 1 B. T. A. 859; *The Hoover-Bond Co.,* 1 B. T. A. 929. To meet the situation thus created Section 212 (d), *infra,* was inserted in the 1926 Act in order to validate the "principles of the Commissioner's regulations." (Senate Report No. 52, 69th Cong., 1st Sess., p. 19.) It is stated in the Conference Report (H. R. No. 356, 69th Cong., 1st Sess., p. 32):

[2] Article 116, Regulations 33 (Revenue Acts of 1916 and 1917); Articles 42 to 46, inclusive, Regulations 45 (Revenue Act of 1918); Articles 42 to 46, inclusive, Regulations 62 (Revenue Act of 1921); Articles 42 to 46, inclusive, Regulations 65 (Revenue Act of 1924).

> This amendment writes into the bill the basic principles of the installment method authorized by prior regulations. * * *

The purpose of the statute undoubtedly was to confer upon the taxpayer the privilege of restricting taxation of the gain derived from a completed transaction of the character described to the actual receipt in each taxable period of cash or its equivalent. This was done by treating as income a ratable proportion of the receipts in each year from the transaction. The statute describes the transactions to which it is applicable and provides the general formula to be used in applying its provisions. Congress did not, however, undertake to prescribe meticulously the formula to be applied or to define the factors to be employed in all cases. Quite obviously the statute provides only for the simple and usual case of sale of property upon the installment plan. It does not purport to set out all the details material to an application of the general formula, especially in the more complex cases of sales of real property subject to existing mortgages. Section 212 (d) contains three terms, definition of which is essential to the application of the section. These terms are "initial payment," "total contract price," and "purchase price." The section defines "initial payments," but not the other two terms. These details in the administration of the statute were left for the Commissioner of Internal Revenue to prescribe in regulations which the statute directed be adopted.

Under this authority, Article 44, of Regulations 69, in which these terms were defined, was promulgated. This Article provides that in the sale of mortgaged property the amount of the mortgage, whether the property is taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall not be considered as a part of the "initial payment" or of the "total contract price," except to the extent that the mortgage may exceed the cost or other basis to the seller.

In the regulations prior to those under the 1926 Act, there was no express reference to the treatment of mortgages assumed by the purchaser. Article 44, Regulations 65, under the 1924 Act, was substantially the same as Article 44 [3] in Regulations 69, except the last paragraph which reads as follows:

> In determining how these classes shall be treated in levying the income tax, the question in each case is whether the income to be

[3] As originally promulgated on August 28, 1926, the last paragraph of Article 44, Regulations 69, reads as follows:

"In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall not be considered as a part of the 'initial payments' or of the 'total contract price,' but shall be included as part of the 'purchase price,' as those terms are used in section 212 (d), in articles 42 and 45, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the 'initial payments,' the 'total contract price,' or the 'purchase price.'"

> **reported for taxation shall be based only on amounts actually received in a taxing year, or on the entire consideration made up in part of agreements to pay in the future.**

In the instant case the vendee in each sale assumed mortgages placed upon the properties by the respondent. The 1924 sale is typical of the usual sale of real property encumbered with a mortgage, where the amount of the mortgage which is assumed by the purchaser as part of the total consideration is less than the depreciated cost or other basis of the property to the seller. The 1925 sale presents the unusual case infrequently encountered in the administration of the installment sales provision of the statute, where the amount of the mortgages assumed by the purchaser is greater than the depreciated cost or other basis of the property to the seller. The problem presented in such cases is how the mortgages which are assumed as part of the total consideration for the property shall be treated in determining the factors to be used in the formula prescribed by the statute.

Whether the statute is applicable to a particular sale depends upon the relation of the amount of the initial payment, which is defined by the statute, to the total consideration. In this case it is not disputed that the statute is applicable to both sales. In the application of the statute it is essential that there be a determination of the percentage of profit and the amount of the payments re-

ceived in each year to which the percentage is to be applied. The percentage of profit is the ratio of the "total profit" to the "total contract price" and a proper interpretation of the term "installment payments actually received" is determinative of the amount to which the percentage must be applied. These material terms are not defined by the statute, but only by the regulation.

The court below, holding the regulation invalid and sustaining the respondent's method of computing the annual profit on the sales, was of the opinion that the amount of the mortgages assumed by the purchaser should be included in the "total contract price," as a factor in the ratio prescribed by the statute, and that payments by the purchaser to the mortgagee upon the assumed mortgages should be included in "installment payments actually received" as and when such payments are made.

The decision below, we submit, does not conform to the statute and fails to give effect to its purpose. Under the construction adopted by the court, the terms "installment payments actually received" and "total contract price" bear no relation to receipts by the taxpayer (seller), but are measured by payments made by the purchaser to both the taxpayer and third persons, holders of the mortgages assumed. As a result the taxpayer may be required to report income in a year in which he has received nothing and even in years long after he has received all payments due him. Such a result

is inconsistent with the general scheme of accounting contemplated by the Revenue Acts and measures the taxpayer's income, to some extent at least, by the receipts of another. This, it is believed, was not contemplated by Congress, which must have intended apportioning only the payments received by the taxpayer.

Moreover, the decision of the court below presents great difficulties of administration. Under that decision it is necessary to take account of the payments made by the purchaser in each year, not only to the taxpayer but also to the holders of the mortgages, which latter payments are not necessarily reflected on the taxpayer's books. The obstacles thus confronting the Treasury Department in the proper audit of the returns of the taxpayer and in the assessment and collection of taxes are obvious. These obstacles are even more serious in the event of subsequent transfers of the mortgages or the property. Further difficulties would be encountered were a corporate taxpayer, like the present respondent, to dissolve before all payments upon the mortgage have been completed by its vendee.

The regulation (Article 44, Regulations 69), on the other hand, provides the most logical and practicable method for giving effect to the intent and purpose of the statute, and is free from the serious defects inherent in the method sanctioned by the court below. The regulation provides that the amount of assumed existing mortgages shall be in-

cluded in the "purchase price" but, to the extent it does not exceed the "basis" (for determining gain or loss), shall not be included as part of "the initial payments" or of "the total contract price." Under the rule thus prescribed the amount of assumed mortgages, while considered a part of the total consideration for the sale, is excluded from "the total contract price," which is taken to mean the aggregate payments to be received *by the seller alone*. Likewise, payments on the assumed mortgages are excluded from the "installment payments actually received," which latter phrase is taken to mean only installment payments received by the seller. The excess, if any, of the assumed mortgages over the "basis" is treated as income realized at the time liability is assumed by the purchaser.

We believe that the statute contemplates apportioning only the payments actually received in each year by the taxpayer in the ratio that total profit on the transaction bears to the aggregate amount to be received by the taxpayer under the contract. This seems to be the clear import of Section 212 (d), which permits the taxpayer to return as income a proportion of the installment payments actually received during the year. The method prescribed by the regulations effectuates this purpose of the statute and conforms to the general scheme of the Act to measure the tax by the receipts of the person subject to the tax. By this method the respondent will have reported as income the entire amount of its gain on the sales by the time the payments due

to it are completed. Payments made and to be made to third persons as holders of the mortgages assumed are eliminated from consideration in apportioning the income taxable annually to the respondent. Under the method sanctioned by the court below there is no relation between the respondent's receipts and the amount of income chargeable to it. The only use of "total contract price" is as a factor of the ratio by which annual receipts are apportioned between income and return of cost of the property to the taxpayer. The regulation, by excluding therefrom assumed mortgages, gives the term the meaning of the total amount of money or its equivalent to be received by the seller under the contract and likewise limits the installment payments to actual receipts by him. This method seems to us the only one consistent with the purpose of the statute and affords the only practical rule for proper administration.

The court below suggests that the regulation is inconsistent in that the mortgages assumed, to the extent they exceed the basis (for determining gain or loss) of the property to the seller, are required to be treated as part of the total contract price and also of the initial payments received by the seller in the year of sale, while the balance of the mortgages are excluded from the computation. These were the conditions obtaining in the sale made by the respondent in 1925. The suggested inconsistency, we submit, is more apparent than real. The excess of assumed mortgages over the "basis" is properly

treated as realized income to the taxpayer at the time of assumption of liability by the purchaser, for the taxpayer is then relieved of primary liability; and to the extent of such excess, theretofore received as a loan, the taxpayer has at that time derived income.[4] See *United States* v. *Kirby Lumber Co.*, 284 U. S. 1.

Somewhat the same situation as obtained here in the 1925 sale was involved in *Lucas* v. *Schneider*, 47 F. (2d) 1006 (C. C. A. 6th), certiorari denied, 284 U. S. 622, where the regulation in question was upheld. In that case the question was whether the transaction constituted an installment sale. If the sum by which the assumed mortgages exceed the basis were treated as part of the "initial payments," as provided by the regulation, such payments would amount to more than one-fourth of the

[4] While it is true that there is a contingency that at a later date the vendor of encumbered property may be compelled by his vendee's default to satisfy his secondary liability by paying off the mortgage, this circumstance does not affect the taxability of the amount of the mortgage in excess of the basis of the property to the vendor. It is settled that a transaction otherwise closed is not uncompleted and that the receipt of income is not deferred for purposes of taxation beyond the year in which received merely because there exists some potential liability by reason of which a loss may be sustained. See *Clemmons* v. *Commissioner*, 54 F. (2d) 209 (C. C. A. 5th); *Ford* v. *Commissioner*, 51 F. (2d) 206 (C. C. A. 6th), certiorari denied, 284 U. S. 666; *Board* v. *Commissioner*, 51 F. (2d) 73 (C. C. A. 6th), certiorari denied, 284 U. S. 658; *Commissioner* v. *Moir*, 45 F. (2d) 356 (C. C. A. 7th). In the event of such later loss, a deduction is proper as of the date when it is incurred.

purchase price, and the sale would not be an installment one. The taxpayer claimed such sum should be excluded, but the court sustained the provision of the regulation requiring its inclusion. The court said (p. 1008):

> By virtue of his authority under section 1101 of the Revenue Act of 1926 (26 USCA §1245), the Commissioner on August 28, 1926, promulgated Internal Revenue Regulation No. 69, and by article 44 thereof excluded the mortgages from the initial payments. Regardless of whether this was a valid regulation, it was accepted by the Board of Tax Appeals as legally and equitably sound when applied to the facts of the particular cases coming before the Board. See *Dalriada Realty Co.*, 5 B. T. A. 905, 908; *Watson* v. *Comm'r*, 20 B. T. A. 270, 272; see also *Pacheco Creek Orchard Co.*, 12 B. T. A. 1358; and *J. W. McWilliams*, 15 B. T. A. 329. But in none of these cases did the mortgages exceed the basis to the vendor of the property sold. The case in hand presents a different situation. Here the mortgages did exceed the basis to the vendor in the sum of $37,802.54, and the situation is controlled by the last paragraph of art. 44 as amended by Treasury Decision No. 4255, which provides that, "in the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser—to the extent it does not exceed the basis to the vendor of the property sold—

> shall not be considered as a part of the initial payments," provided article 44 as thus amended is a valid regulation. We see no reason for questioning its validity in this case. It adds nothing to initial payments which may not be added under the statute. We think the effect of it was to reflect more clearly the real meaning of the statute and to require the income to be returned during the taxable period in which it was received.

That case and the instant one are distinguishable in that here the "initial payments" including the excess of the assumed mortgages over the "basis" did not exceed one-fourth the purchase price and hence the installment provisions concededly are applicable; but the court in the *Schneider case* could not have reached the result of the decision without approving the regulation now attacked.

No inconsistency results from excluding the amount of the assumed mortgages not in excess of the "basis" from the "total contract price" and the payments thereon from "installment payments actually received," for payments on such mortgages are not to be made to the taxpayer; and while counted in full as part of the total consideration for the sale, the assumption of the mortgages to the extent not in excess of the "basis," may properly be treated as a return of the "basis," and hence excluded from both factors of the ratio applicable in computing the amount of income realized by the taxpayer from each installment pay-

ment. To the extent of the excess of the assumed mortgage over the basis, on the other hand, there is a gain to the taxpayer, the full benefit of which is received in the year of sale just as much as though it were received in cash or other property. *Lucas* v. *Schneider, supra,* approves the method of dealing with such an excess amount prescribed by the regulation, and we submit no good reason appears for not following that method in the present case.

It is expressly provided in Section 212 (d) that the permission to return income on the installment basis is conditioned upon compliance with regulations prescribed by the Commissioner with the approval of the Secretary. Thus Congress indicated its intention that the administrative officers should work out the details of the application of the principle adopted. In *United States* v. *Grimaud,* 220 U. S. 506, 517, this Court upheld the power of Congress to give to those charged with the administration of the law " 'power to fill up the details' by the establishment of administrative rules and regulations, * * *." The regulations are valid and binding unless unreasonable or inconsistent with the statute. Not only is this regulation reasonable and consistent with the statute, but it effectuates its purposes in a practical manner. The theory of the court below conflicts with the purpose and intent of the statute, and with the principles of installment accounting. It would be impossible

to determine from any of the usual accounting records that might be kept by the respondent what its income was in any year, since payments made by the purchasers to the holders of the mortgages would not be reflected in such records.

The regulation nullified by the decision of the court below has been consistently upheld by the Board of Tax Appeals. See *Frank J. Bosshardt*, 4 B. T. A. 1262; *Dalriada Realty Co., Inc.*, 5 B. T. A. 905; *Pacheco Creek Orchard Co.*, 12 B T. A. 1358; *J. W. McWilliams*, 15 B. T. A. 329; *Katherine H. Watson*, 20 B. T. A 270; *Fifty-three West Seventy-second Street, Inc.*, 23 B. T. A. 164; *Metropolitan Properties Corporation*, 24 B. T. A. 220. Moreover, the statute to which the regulation applies was substantially reenacted in the Revenue Act of 1928, c. 852, Sec. 44 (b), 45 Stat. 791, 805, and in the Revenue Act of 1932, c. 209, Section 44 (b), 47 Stat. 169, 186. Regulations 74, Article 352, applicable to the 1928 Act, repeat, so far as presently material, the regulations now in question. Under these circumstances, the administrative interpretation of the statute should not be disregarded. See *Murphy Oil Co.* v. *Burnet*, decided December 5, 1932 (No. 80, October Term, 1932); *Interstate Commerce Commission* v. *New York, New Haven & Hartford R. Co.*, decided November 21, 1932 (No. 15, October Term, 1932); *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375; *Brewster* v. *Gage*, 280 U. S. 327, 337.

CONCLUSION

The decision below is erroneous and should be reversed.

Respectfully submitted.

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JANUARY, 1933.

APPENDIX

STATUTES AND REGULATIONS

REVENUE ACT OF 1926, C. 27, 44 STAT. 9, 23, 41, 130

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. * * * (U. S. C. App., Title 26, Sec. 984.)

SEC. 212. (b) The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but * * * if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

(d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if

in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made. (U. S. C. App. Title 26, Sec. 953.)

SEC. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provisions of * * * the Revenue Act of 1924, * * *. (U. S. C. App., Title 26, Sec. 953 (a).)

TREASURY REGULATIONS 69

ART. 44. *Sale of real property involving deferred payments.*—Under section 212 (d) deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed one-fourth of the purchase price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed one-fourth of the purchase price.

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CHARLES ELMORE CROPLEY

No. 475

IN THE

Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,

v.

S. & L. BUILDING CORPORATION.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT

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OCTOBER TERM, 1932

No. 475

DAVID BURNET, Commissioner of Internal Revenue,
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S. & L. BUILDING CORPORATION.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

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BRIEF FOR THE RESPONDENT

QUESTION PRESENTED

The question presented by the petitioner is broader than the facts in the instant case warrant.

Correctly stated, the question is, whether the first sentence of the last paragraph of Article 44 of Treasury Regulations 69, as amended, is valid when applied to the facts in this case involving the sales of mortgaged property, where the purchasers assumed the mortgages which were originally given by the seller (respondent) who remains liable thereon, until actual payments are made by the purchasers of the property.

STATEMENT

Petitioner's statement omits the respondent's method of computing profit on the installment plan of the sales of properties, 82nd Street and Broadway and 83rd Street Street and Broadway, respectively, which was approved by the Circuit Court of Appeals.

As to 82nd Street and Broadway property, which was sold in the year 1924, the respondent, pursuant to Section 212 (d) of the Revenue Act of 1926, computed the profits on the installment plan in the following manner:

Total Profit to be Realized		$ 558,676.52
Total Contract Price (Purchase Price)		2,100,000.00
Percentage of total profit ($558,676.52) to total contract price ($2,100,000.00)		26.603643%
Initial Payments:		
Cash	$300,000.00	
Payments on purchase money mortgage	30,000.00	
Payment on December 1, 1924 by purchaser on mortgage assumed	22,000.00	352,500.00
Profit realized in 1924 (26.603643% times initial payment of $352,500.00)		93,644.82

For the year 1925, the purchaser of this property made the following payments on account of the total contract price of $2,100,000.00.

Payments on purchase money mortgage	$ 36,250.00
Payments on mortgage assumed	44,000.00
Total	$ 80,250.00

The respondent computed the realized profit applicable to these payments in 1925, to be $21,349.42 (26.603643% times $80,250.00 equals $21,349.42).

As to the sale in 1925 of 83rd Street and Broadway property, reported on the instalment plan, the respondent by following the above method determined the realized

profit for 1925 applicable to this sale in the following manner:

Total Profit to be Realized		$ 642,967.00
Total Contract Price (Purchase Price)		2,165,000.00
Percentage of total profit to total contract price		29.698244%
Initial payments:		
Cash	$300,000.00	
Payment on purchase money mortgage	2,000.00	
Payment during 1925 on first mortgage assumed	None	
Payment on second mortgage assumed	22,500.00	324,500.00
Profit realized in 1925 (29.698244% times initial payment of $324,500.00)		96,370.80

ARGUMENT

The petitioner states as reasons for granting the writ, that (1) the decision of the Circuit Court of Appeals conflicts in principle with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Lucas* v. *Schneider*, 47 F. (2d) 1006, certiorari denied, 284 U. S. 622; (2) the decision will result in filing of refund claims and the imposition of increased deficiencies as well as raising new issues all of which will present great difficulties of administration; (3) the decision provides a method of computing income on the installment plant which is inconsistent with the general scheme of accounting contemplated by the Revenue Acts.

The Circuit Court of Appeals has considered these arguments of the petitioner and by its decision has clearly rejected these contentions. The decision stated that *Lucas* v. *Schneider* "has no bearing on the situation here,—we need here only decide whether the regulation is a correct interpretation as to the calculation of the return." The Circuit Court of Appeals for the Sixth Circuit was called upon, however, to decide whether the taxpayer had a right to the use of the installment method of reporting income,

and not to determine the correct method by which the total profit is to be returned annually on the installment plan. The petitioner has at all times conceded that the respondent is entitled to report the profit from the sale of these two properties on the installment plan. There is no dispute about this. But the dispute arises, however, as to whether regulations 69, Article 44, as amended, is a correct interpretation of the Statute as to the calculation of the return.

This regulation provides:

> "In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the 'purchase price' but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as part of the 'initial payments' or of the 'total contract price', as those terms are used in Section 212 (d), in Articles 42 and 45, and in this Article. * * *"

Prior to the amendment of this regulation approved January 8, 1929, after the issuance by the petitioner of the deficiency notice dated February 4, 1928 (R. 11), the regulation read as follows:

> "In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage, or whether the mortgage is assumed by the purchaser, shall not be considered as part of the 'initial payments' or of the 'total contract price' but shall be included as part of the 'purchase price', as those terms are used in Section 212 (d), in Articles 42 and 45, and in this Article. * * *"

The above quoted regulations completely ignore a case such as this, where the seller borrows money and gives his

bond and mortgage securing said loan, upon which he remains liable until it has actually been paid off either by him directly, or for him by the purchaser who assumes this obligation. It is contended by the respondent that the seller is relieved of this mortgage obligation only when payments thereon are made, and to the extent of these payments, the portion of profit applicable thereto, computed on the installment basis provided by law, will be considered income by him when paid.

The petitioner cites the case of *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, to support his contention that the assumption by the purchaser of the mortgage obligation to the extent that it exceeds the basis of the property results in income, for the reason that as between the purchaser and seller, the latter has been relieved of his liability. It is quite apparent that the *United States* v. *Kirby Lumber Co.* case has no bearing on this issue. In that case, the Supreme Court held "that where a corporation purchases and retires its own bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is taxable income for the taxable year." The retirement of an obligation is entirely different than the assumption of an obligation. In effect, the retirement of a bond obligation cancels it forever, while the assumption keeps the obligation alive; the obligor being relieved to the extent that the payments, pursuant thereto, have actually been made.

Furthermore, the regulation is inconsistent when it requires the splitting up of the entire mortgage obligations, considering that part which exceeds the basis of the property, as having been cancelled and consequently taxable income, while the balance of the mortgage obligations it considers as a return of the cost. This treatment of

mortgage obligations is contrary to Section 212 (d) of the Revenue Act of 1926, which grants a privilege of reporting profits on the installment plan. Moreover, the regulation, when applied to this case, violates this section, by requiring respondent to report part of the profits on the installment basis and part on the accrual basis. It requires the respondent to report a greater profit in the year of sale than the law contemplated. On the sale in 1925, of 83rd Street and Broadway property, the petitioner computes the portion of the total profit applicable to this year, at $379,967.00, whereas, according to respondent's computation, the amount should be $96,370.80. The effect of the petitioner's computation is that it creates an unwarranted larger profit to be returned in the year of sale than that authorized by law, thereby depriving him of its advantages. Inasmuch as Section 212 (d) was enacted primarily to benefit the taxpayer, it should be construed liberally in his favor. *Bowers* v. *New York and Albany Lighterage Co.*, 273 U. S. 346. Therefore, the regulation, which excludes a portion of the mortgages assumed from the "total contract price" in arriving at a percentage of profit to be returned on each installment, and includes a portion of the mortgages as part of the "total contract price" where such portion exceeds the base, is inconsistent with the statute, unreasonable, and therefore declared invalid by the Circuit Court of Appeals.

The petitioner's contention, that the decision will result in filing of refund claims and impose increased deficiencies, appears to be no argument for granting a writ of certiorari.

The petitioner's arguments, that the regulation nullified by the decision of the Court below has been consistently upheld by the Board of Tax Appeals; that the statute to which the regulation applies was substantially re-enacted

in the Revenue Act of 1928; that under these circumstances the administrative interpretation of the statute should not be disregarded, are completely answered by the Circuit Court of Appeals, Fifth Circuit, in its decision, *Central Real Estate Corp.* v. *Commissioner,* 47 Fed. (2d) 1036.

The respondent's method of computing income on the installment plan presents no difficulties of administration. On the contrary, it establishes an equitable uniform basis which may be followed by all taxpayers who elect to return the profit from the sale of property on the installment plan. The taxpayers' books, if properly maintained along the lines of recognized accounting procedure, should reflect, according to either the respondent's or petitioner's method of reporting profit on the installment plan, appropriate accounts, including accounts variously designated as "Deferred Profits from Sale of Properties on Installment Plan", or Reserve for Unrealized Profits from Sale of Properties on Installment Plan". This account at all times reflects the amount of profit not as yet realized. Appropriate journal entries are made at the end of each calendar or fiscal year transferring from this account the realized profit computed in accordance with respondent's method. Aside from the method of bookkeeping employed by a taxpayer, it has been held that income is a "matter of fact—not of bookkeeping". *Maryland Casualty Company* v. *United States,* 251 U. S. 342; *B. B. Todd, Inc.,* 1 B. T. A. 762.

Contrary to the claims of the petitioner, that the decision of the Circuit Court of Appeals will create confusion in the administration of Federal tax laws, it is contended by the respondent that this decision will clarify the last paragraph of Article 44 of the Regulations 69 as amended, by eliminating the inconsistencies that now exist therein.

This decision will provide a uniform method of applying Section 212 (d) of the Revenue Act of 1926, as well as the subsequent Revenue Acts. This regulation, which has been declared by the Circuit Court of Appeals to be invalid when applied to the facts in this case, does not carry out the intent of Congress to relieve taxpayers of the burden of paying taxes on profits not yet realized.

It is significant to note that under present adverse conditions, many foreclosures have taken place on real estate, resulting in considerable losses to taxpayers who were called upon to make good the deficiencies arising out of their liability on their bond and mortgages, even though they were assumed by the purchasers of their properties. Consequently, the inconsistency of the regulations is more real than apparent. The decision of the Circuit Court of Appeals takes cognizance of this liability by considering the existing mortgages on the property as a part of the "total contract price".

It would, therefore, be a simple matter for the petitioner to conform the regulations to this decision by amending the last sentence of Article 44 of Regulations 69 and subsequent regulations. Section 605 (Revenue Act of 1928) amending Section 1108 (a) of the Revenue Act of 1926, provides for the amendment of regulations without retroactive effect.

CONCLUSION

The application for writ of certiorari should be denied for the reasons that the petitioner failed to prove in his petition that the Circuit Court of Appeals has erred in its decision; that no conflict exists between this decision and other Circuit Court of Appeals decisions; that no confusion will exist in the administration of Section 212 (d) of the Revenue Act of 1926 and subsequent Revenue Acts,

if the petitioner will properly amend the applicable regulations to conform to this decision which correctly interprets Section 212 (d) of the Revenue Act of 1926.

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October, 1932.

APPENDIX

STATUTES.

Revenue Act of 1926.

Sec. 212 (d). Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made. (U. S. C. App., Title 26, Sec. 953.)

Revenue Act of 1928.

Sec. 605. Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary, or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.

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JAN 16 1933

CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM 1932

No. 475

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

S. & L. BUILDING CORPORATION.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF ON BEHALF OF RESPONDENT

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IN THE

Supreme Court of the United States

OCTOBER TERM 1932

No. 475

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

S. & L. BUILDING CORPORATION.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF ON BEHALF OF RESPONDENT.

Opinions Below.

The opinion of the Circuit Court of Appeals (R. 42-44) is reported in 60 F. (2d) 719. The findings of fact and opinion of the Board of Tax Appeals (R. 26-33) are reported in 19 B. T. A. 788.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered July 26, 1932 (R. 45). Petition for certiorari was filed on October 25, 1932 (R. 45), and granted December 5, 1932 (R. 45). Jurisdiction is conferred upon this Court

by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

The respondent, in its brief in opposition to the petition for a writ of certiorari, submitted to this Court as the question presented, the following:

Whether the first sentence of the last paragraph of Article 44 of Treasury Regulations 69, as amended, is valid when applied to the facts in this case involving the sale of mortgaged property where the purchasers assumed the mortgages which were originally given by the seller (respondent) which remains liable thereon, until actual payments are made by the purchasers of the property.

This question, properly subdivided, presents to this Court the several questions which the respondent herein presented to the Circuit Court of Appeals. These questions substantially are as follows:

1. Whether, in the case of sale of real estate reported on the installment plan where the purchaser assumed the unpaid mortgage loans which were originally obtained by the seller (respondent), the "total contract price", as that term is used in Section 212 (d) of the Revenue Act of 1926, includes the mortgages assumed.

2. Whether the payments made by the purchaser direct to the mortgagees on the mortgages assumed by him are to be included by the seller as part of the "initial payments" in the year of sale, and as part of "installment payments actually received", as those terms are used in Section 212 (d) of the Revenue Act of 1926.

3. Whether an item, representing the excess of the mortgages assumed over the cost basis or other basis of the property, is to be reported as income by the seller in the year of sale.

Statute and Regulations Involved.

The applicable statutes and regulations are set forth in the petitioner's Appendix (pp. 24-26).

Additional regulations, which the respondent deems applicable, are set forth in the Appendix, pp. 28-29, *infra*.

Statement.

All of the facts material to the present issue are set forth in the petitioner's brief (pp. 2-7), with the exception that the respondent deems it material to add that the mortgage loans which were assumed by the purchaser were obtained by the respondent prior to the sale of the properties. The first mortgage loan of $1,100,000.00 on 82nd Street and Broadway property was obtained by respondent in the year 1923 (R. 27). First mortgage loan on 83rd Street and Broadway property of $1,100,000.00 and second mortgage loan of $500,000.00 were obtained by the respondent in the year 1924 (R. 27).

Summary of Argument.

The statute involved is Section 212 (d) of the Revenue Act of 1926. This section provides a new method for taxing gross profits realized from the installment sales of property. It was designed to allow a taxpayer in the case of installment sales to spread the profits over the whole period during which payments were made so as to avoid loading all of it upon those years which followed the amorti-

zation of the original cost. The formula determining the profit reportable on the installment sales is found in the statute itself. In this formula the term "total contract price" is used. This term, if to be applied at all to the sales of real property, includes the mortgages assumed by the purchaser.

The Commissioner is authorized to make regulations interpreting the statute, but such regulations must be reasonable and consistent. The regulations adopted by the Commissioner are not consistent in the interpretation of the statute for the reason that the words of the statute are read in one sense in one connection and differently in another. The Commissioner includes all mortgages assumed in the "purchase price" but excludes them to the extent they exceed the "basis" from the "initial payments" and the "total contract price". The effect of this is to treat as "installments actually received" in the year of sale that portion of the mortgages assumed by the vendee which exceeds the "base". Again this excess of mortgages assumed over the base is excluded from the denominator of the fraction to be applied to each "installment actually received" to determine the taxable profit included in that installment, while the minuend for determining the total taxable profit includes all of the mortgages assumed.

To be consistent the regulations adopted by the Commissioner should include the payments made by the purchasers on the mortgages assumed to the mortgagees as part of the "initial payments" and as part of "installment payments actually received" as those terms are used in Section 212 (d). The application of this method would result in there being no excess of the mortgages assumed over the basis of property in calculating profits on the install-

ment plan. Further, no profit escapes tax, nor is any year unduly loaded with profit.

Under the ruling of the Court below, holding the regulations invalid, a consistent method of calculating the return of profits is adopted. The method approved does no great violence to the words in the section; it results in an equitable method; it is not unfair even though it may result in imposing a tax after direct payments have ended, for the section is not compulsory but merely gives an option and the taxpayer may not object to what he can avoid. The decision below is consistent with the general scheme of the Revenue Acts, the recognized accounting principles and gives effect to the purpose of the statute in question.

ARGUMENT.

POINT I.

Section 212 (d) of the Revenue Act of 1926 provides for a new method for taxing gross profits realized from the installment sales of property which has for its purpose the spreading of the profit over the whole period during which payments are to be made by purchasers.

Prior to the enactment of Section 212 (d) of the Revenue Act of 1926, there existed no express provision for reporting income on the installment basis. *Appeal of B. B. Todd, Inc.*, 1 B. T. A. 762; *Appeal of H. B. Graves Co., Inc.*, 1 B. T. A. 859; *Appeal of The Hoover-Bond Co.*, 1 B. T. A. 929.

The dual basis for reporting taxable income, namely, the basis of cash receipts and disbursements or the basis of accrual, were the only two methods of reporting income

authorized by earlier Revenue Acts. Section 212 (d) of the Revenue Act of 1926, created a third basis separate and apart from cash receipts and disbursements or accrual bases. The Committee on Finance, in submitting its report to accompany H. R. 1 on the Revenue Bill of 1926, entitled Senate Report #52, 69th Congress, First Session, clearly stated, in discussing the proposed Section 212 (d), that it was to provide a third method of reporting income. It was said in that report, at page 19:

> "Section 212 (d): The revenue act of 1924 and prior acts have specifically provided two bases only for reporting income—first, cash receipts and disbursements, and, second accrual. Since the enactment of the revenue act of 1921, however, section 202 (f) and its successors have impliedly recognized the existence of a third basis, the installment basis, without in anywise defining the situations and businesses to which such basis might be applied. The Commissioner of Internal Revenue has in his regulations provided, in pursuance of his authority to require a method of computation that will clearly reflect income, the installment basis for reporting income in certain cases. * * *
>
> "However, recent decisions of the Board of Tax Appeals (see appeal of 650 West End Ave. Co., appeal of Manomet Cranberry Co., and appeal of B. B. Todd (Inc.)—all decided during the past year) have held that similar regulations under earlier acts were invalid and that the commissioner under the law could authorize no basis other than the cash receipts and disbursements basis or the accrual basis, except for certain minor departures. The committee amendment, in order to meet the situation resulting from the decisions, places the principles of the commissioner's regulations in the law and thereby validates the regulations for all periods after January 1, 1925."

The method to be employed in calculating taxable income from the sale of property under each basis is as follows:

(a) *Cash Basis*—Under the cash basis of reporting profits from the sale of properties, the consideration for the sale of the property when realized in cash or its equivalent is first applied to the cost or the basis of the property sold, and any amount in excess thereof, when received, constitutes taxable profit in the year of receipt.

(b) *Accrual Basis*—Under the accrual basis for reporting income, the entire profit is considered taxable during the year in which the sale of the property is made.

(c) *Installment Basis*—Under the installment basis for reporting profits from the sale of property, the profits are apportioned and spread over the whole period during which payments are to be made so that a portion of the payments, when made, represents profit and a portion thereof represents a return of the cost or basis.

It is not necessary to discuss the deferred payment sales not on the installment plan, except to state that the Commissioner applies this method to cases which do not come within the 25% limitation under Section 212 (d) of the 1926 Act. This method precludes a taxpayer from reporting the profits on the installment plan.

The Commissioner, in Articles 44 and 45 of Regulations 69 and earlier regulations, separated deferred payments into two classes:—(1) Sale of property on the installment plan, and (2) Deferred payment sales not on the installment plan.

Under Article 45, Regulations 45, dealing with the sale of real estate on the installment plan, the Commissioner

treats the installment obligation assumed by the buyer as follows:

> "* * * installment obligations assumed by the buyer are not ordinarily to be regarded as the equivalent of cash, and the vendor may report as his income from such transactions in any year that proportion of each payment actually received in that year which the gross profit to be realized when the property is paid for bears to the gross contract price. * * *"

The later Regulations of the Commissioner, Article 45[1], Regulations 62 and 65, had a slight change in wording from that of Article 45, Regulations 45. This change in no way affected the treatment of installment sales.

It is apparent from these Regulations, which in principle, according to the Senate Report above referred to, were to be enacted into the law (Section 212 (d)), that the mortgages assumed were not to be treated as the equivalent of cash, but were to be considered as part of the consideration which, when paid, was to be returned by the seller as taxable income in the proportion which the gross profit bears to the gross contract price.

The installment basis for reporting income was designed to allow a taxpayer, in the case of installment sales, to spread the profit over the whole period during which payments were made, so as to avoid loading all of it on those years which followed the amortization of the original cost. (See Opinion L. HAND, *C. J.*, in this case, C. C. A., Second Circuit.) (R. 42-44.) Consequently, it was the intent of Congress, when enacting Section 212 (d), to prescribe a formula for reporting profits on the installment plan. This formula has for its denominator, or base, the total or gross contract price, and for its numerator, the

[1]Article 45, Regulations 65 and 69, are set forth in the Appendix, pp. 28, 29.

gross profit. The ratio or percentage obtained therefrom is then applied to each payment required to be made by the purchaser pursuant to the purchase contract.

If the petitioner's conception of the purpose of Section 212 (d) is correct, it will be difficult to distinguish between the different methods of reporting profit without confusing or intermingling one with the other. Under his interpretation[2] of the statute, there apparently would be no segregation of the payments received in relation to cost and profit. The petitioner treats, contrary to his prior regulations, the mortgages assumed as the equivalent of cash received by the seller, and applies the entire amount of the mortgages assumed in amortizing the cost or basis of the property sold. This is contrary to the principle of reporting profits on the installment plan.

The taxpayer must be consistent in its method of reporting income. Section 13 (d) of the Revenue Act of 1916 has been construed by this Court, and it was held that taxpayers were not permitted to file returns upon a mixed basis of receipts and disbursements as to some items and accrual as to other items, as such a return would not reflect true net income. *United States* v. *P. Chauncey Anderson, et al., etc.*, 269 U. S. 422.

In Section 212 (b) of the Revenue Acts of 1921, 1924 and 1926, Congress substantially re-enacted the provisions of Section 13 (d) of the Revenue Act of 1916. A new section was added to Section 212 of the Revenue Act of 1926, namely, Section 212 (d), which provides for reporting profit on the installment plan. With this new provision the three methods of reporting income, discussed above, were recognized by Congress—(1) Cash receipts and disbursements, (2) Accrual, and (3) installment.

[2]Article 44, Regulations 69, set forth in Appendix, p. 28.

Any one of these methods, when properly applied, should by itself clearly reflect income. A mixed basis is not permissible. *United States* v. *P. Chauncey Anderson, et al., etc., supra.* To apply different methods to a single transaction would obviously not reflect true net income. This is precisely what the Commissioner proposes in the respondent's case. He concedes that the installment method is proper, in the case before the Court. (Pet. br., p. 13, line 4, last par.) The Commissioner treats the excess of the mortgages assumed over the basis, in the sale of the 83rd Street and Broadway property, as taxable profit in the year 1925 for the reason that the taxpayer filed the return on the accrual basis. To support this treatment of the excess of the mortgages assumed, he relies upon the first sentence of the last paragraph of Article 44 of Treasury Regulations 69, as amended. The respondent's method is not open to this criticism.

The respondent's method of computing income on the installment plan presents no difficulties of administration. On the contrary, it establishes an equitable uniform basis which may be followed by all taxpayers who elect to return the profit from the sale of property on the installment plan. The taxpayer's books, if properly maintained along the lines of recognized accounting procedure, should reflect, according to either the respondent's or petitioner's method of reporting profit on the installment plan, appropriate accounts, including accounts variously designated as "Deferred Profits from Sale of Properties on Installment Plan", or "Reserve for Unrealized Profits from Sale of Properties on Installment Plan". This account at all times reflects the amount of profit not as yet realized. Appropriate journal entries are made at the end of each calendar or fiscal year transferring from this account the

realized profit computed in accordance with respondent's method.[3] The difficulties of administration and bookkeeping urged by the petitioner are seeming rather than real. Even if such difficulties were real, it has been held that income is a "matter of fact—not of bookkeeping". *Maryland Casualty Company* v. *United States*, 251 U. S. 342; *B. B. Todd, Inc.*, 1 B. T. A. 762.

POINT II.

The "total contract price", as that term is used in Section 212 (d) of the Revenue Act of 1926, if to be applied at all to sales of real property, includes the mortgages assumed by the purchaser.

The statute, Section 212 (d) of the Revenue Act of 1926 does not require, nor does it prescribe a different computation than that which the respondent used. True the statute says that the Commissioner may make regulations, but in the statute itself we find the formula for determining the profit reportable on installment sales. This formula is not the one approved by the Board of Tax Appeals in the instant case. The formula uses the phrase "total contract price" in connection with sales of personalty. It is the respondent's contention that if this phrase is to be applied to sales of real property, then the phrase includes mortgages assumed. This contention of the respondent has received the approval of the Circuit Court in the instant case. The Circuit Court, in its opinion, approves this contention by stating:

> "Again, the regulation involves an equivocal use of the phrase, 'total contract price'. Obviously the denominator of the fraction to be applied to each 'in-

[3]See Appendix, p. 30, for appropriate journal entries.

stallment actually received', must be the sum of all such installments. If it be larger, the whole profit will never be covered. For this reason the regulation, which does not include among installments payments upon the assumed mortgages, excludes their face from the denominator. Yet in calculating the profit it necessarily includes the mortgages in the minuend, else there would ordinarily never be any profit. But the section, which necessarily implies that profit shall be reckoned by using a price which includes all the mortgages, can not mean something else when speaking of the denominator of the fraction. In defining the condition upon the privilege in the case of realty it uses the phrase, 'purchasing price', but that has nothing to do with the question here; it touches not the calculation of the income to be returned but the right to spread the profit at all. Nevertheless, it is extremely improbable that it means anything else than 'total contract price', and the commissioner here agrees that it includes assumed mortgages." (R. 43, 44.)

Section 212 (d) of the Revenue Act of 1926, and the report of the Committee on Finance accompanying H. R. 1, which discusses Section 212 (d) at page 19, indicates that the section was enacted by Congress for the sole purpose of affording relief to a certain class of taxpayers.*

This Section 212 (d), being a relief measure, should be construed most liberally in favor of the taxpayer. *Bowers* v. *New York & Albany Lighterage Co.*, 273 U. S. 346; *Walter G. Palmer, Trustee*, v. *The United States*, 67 Ct. Cls. 648.

It is an elementary principle of statutory construction that words in the statute should be given their plain and ordinary meaning and that a statute, if possible, will not be construed to lead to unjust or oppressive results.

*See pertinent portions of Senate Report #52, First Session, 69th Congress, Respondent's brief, p. 6.

In addition to the Commissioner of Internal Revenue giving the words "total contract price" an unusual meaning in the regulations, the respondent submits that the construction adopted by the Commissioner leads to unjust and oppressive results, and would result in a taxation of a larger proportion of the anticipated profit than was received in the taxable year. The following tables illustrate the differences between the method employed by the respondent and that of the petitioner in computing the tax:

82ND STREET AND BROADWAY PROPERTY

Year 1924

	Respondent's Method	*Petitioner's Method*
Total profit to be realized	$ 558,676.52	$ 558,676.52
Total contract price	2,100,000.00	1,000,000.00
Percentage of total profit to total contract price	26.603643%	55.86752%
Initial payments:		
Cash	300,000.00	300,000.00
Payments on purchase money mortgage	30,000.00	30,000.00
Payments on Dec. 1, 1924, on mortgage assumed	22,000.00	None
Total	$ 352,000.00	$ 330,000.00
Profit realized in 1924— (Total payments times percentage of total profit)	$ 93,644.82	$ 184,363.25

Year 1925

Payments made during the year 1925 on account of total contract price:		
Payments on purchase money mortgage	$36,250.00	$36,250.00
Payments on mortgages assumed	44,000.00	None
Total	$80,250.00	$36,250.00
Profit realized in 1925— (Total payments times percentage of total profit)	$21,349.42	$20,252.02

83RD STREET AND BROADWAY PROPERTY

Year 1925

	Respondent's Method	*Petitioner's Method*
Total profit to be realized	$ 642,967.00	$ 642,967.00
Total contract price	2,165,000.00	565,000.00
Percentage of total profit to total contract price	29.698244%	100 plus
Initial payments:		
Cash	300,000.00	300,000.00
Payments on purchase money mortgage	2,000.00	2,000.00
Payments during 1925 on first mortgage assumed	None	None
Payments on second mortgage assumed	22,500.00	None
Excess of mortgages assumed over basis of property to taxpayer	None	77,967.00
Total	$324,500.00	$379,967.00
Profit realized in 1925—		
(Total payments times percentage of total profit)	$96,370.80	$379,967.00

The effect of both the respondent's and petitioner's computations is to prevent any income from escaping taxation. The only difference is in the period of time during which the income is reported. In the respondent's method the profit is spread over the entire total payments to be received on account of the total contract price, which it is contended includes the mortgages assumed. The petitioner's method determines total contract price by excluding the mortgages assumed; hence shortening the period for reporting income.

What Congress intended seems clear. When the words "total contract price" were used, Congress evidently did not consider it necessary to define the meaning of the words. Because of the lack of a definition it must have meant that the words should have their ordinary and accepted meaning, but it is to be noted that Congress says "total contract price" not "contract price". In other words, Congress, it is submitted, clearly intended that the total contract price should include all considerations passing to the seller under the contract, and if the seller was to be relieved by the purchaser of a primary obligation on which it was liable, the amount of such obligation was to be included under "total contract price".

The only words in the section which Congress felt needed a definition were the words "initial payments", and Congress defined "initial payments" to include all payments received in cash or property other than evidence of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made. If this definition had not been inserted in the law, "initial payments" might have been construed to include only those payments made on the closing of the sale. It would seem to follow that the absence of a definition of "total contract price" shows the intention of Congress to refer to the total price for the property as it might be fixed under the contract between the seller and the purchaser as "total contract price". In the instant case the contract fixed the price at $2,100,000.00 on the property sold during the year 1924 (R. 28), and the contract fixed the price at $2,165,000.00 for the property sold during the year 1925 (R. 29). Both of these contracts were payable as set forth in the statement of facts (R. 28, 29). The assumption of the mortgages was an essential part of the contracts and

was required so that the liability of the seller on such mortgages might be gradually reduced and the total profit to the seller might be actually realized. As these payments were made, the total profit to the seller was realized. The amount by which such mortgages (mortgages on both pieces of property) would be reduced in any year by payment by the purchasers to the mortgagees was the equivalent of a payment of similar amounts to the seller. *Appeal of James M. Butler,* 19 B. T. A. 718. Such payments represent income to the seller when made on the basis provided by Section 212 (d).

The respondent submits that it was the intention of Congress to provide an equitable method of taxation of profit upon the sale of real property under an installment plan and that the method prescribed by the Commissioner is not equitable, at least in the case which is now before this Court.

What difference, if any, is there between the "purchase price" and the "total contract price"? We believe none.

In the case of *Frank J. Bosshardt*, 4 B. T. A. 1262, the question arose as to what constituted "purchase price". That case involved the sale of lots for $11,000.00 not subject to mortgages or encumbrances. The taxpayer deducted from the selling price the commission of $550.00, Revenue stamps $11.00 and other expenses of $6.00, leaving a net purchase price of $10,433.00. The Board in deciding this case stated (p. 1264):

> "* * * In ascertaining the proportion of profit, the taxpayer has not followed exactly the method there prescribed, in that he has used the ratio which the total profit realized bears to the net sale price, whereas the statute specifies, instead of the net sale price, the 'total contract price'. This results in a slightly larger pro-

portion of profit than if the statutory method were used."

It is noted from this decision that the Board in this case held that the term "total contract price" is the same as the total selling price and not the net sales price.

In Senate Report #52 (Resp. br., p. 6), the term "contract price" has been used by the Committee to be the amount which is to act as a basis for figuring the limitation of 25% provided in Section 212 (d) as well as the basis for reporting the percentage of profit to be returned each year. In other words, no distinction was made in this report between "purchase price" and "total contract price", in so far as those terms are used in Section 212 (d).

If any distinction was intended by Congress between the words "total contract price" and "purchase price", the distinction is this. The term "purchase price" would in any case include the amount of any mortgage upon the premises, for such item would be included within the basis for determining gain or loss on a resale by the purchaser. On the other hand, if there was a mortgage upon the premises at the time of the sale, which was not a personal liability of the seller and which the purchaser did not agree to assume for the seller, the price as fixed by the contract might not include such mortgage. The contract might even make no reference to encumbrances upon the property, such as a first mortgage or taxes accrued against the property. This would amount to a sale of the equity. But in the case where the seller is personally liable upon the mortgage which is already upon the property, and it is provided by the contract of sale that the purchaser will assume the mortgage, then in any event such a mortgage is part of the total contract price for the assumption of the liability of

such mortgage by the purchaser is part of the consideration coming to the seller of the property.

We do not believe Congress thought of any such distinctions. "Total contract price" is used in the portion of the section dealing with personalty, "purchase price" in the portion dealing with realty. The reference back from the realty portion to the personalty portion is just to bring forward the method of computation.

The respondent submits that in the absence of a definition of the term "total contract price" in the statute, the Commissioner can only give to the term its ordinary and usual meaning. This meaning can only be the total price as fixed by the contract of sale, including all considerations inuring thereby to the seller. Where the purchaser agrees to relieve the seller of its primary liability on the mortgage by assuming the mortgage, the amount of this mortgage should therefore be considered as part of the contract price. The ordinary and usual meaning of the term "total contract price" is the price fixed by the contract. See *Vinton Petroleum Company* v. *Sun Company* (C. C. A. 230 Fed. 105, 106).

The Board of Tax Appeals has in several decisions approved the regulations of the Commissioner, insofar as the regulations construe the terms "initial payments", "total contract price" and "purchase price". *Dalriada Realty Co.*, 5 B. T. A. 905; *Pacheco Creek Orchard Co.*, 12 B. T. A. 1358; *J. W. McWilliams*, 15 B. T. A. 329; *Appeal of Fifty-three West Seventy-second Street, Inc.*, v. *Commissioner*, 23 B. T. A. 164.

A study of these decisions shows that the Board has not included its reasoning in approving the regulations.

The regulations which define "total contract price" were considered and construed by the United States District Court, Western District of Kentucky, in the case of *S. J. Schneider, Trustee of the Estate of Bagby-Howe Drug Company,* v. *Lucas,* decided August 3, 1929. The question was not what constituted "total contract price" but whether or not the taxpayer should report on the installment plan basis as provided in Section 212 (d) of the Revenue Act of 1926. In order to answer this question the Court had to determine what constituted the "initial payments". The District Court, by holding that the "initial payments" did not include the excess of the mortgages assumed over the basis, gave the plaintiff the right to the benefit of Section 212 (d). In determining what constituted the initial payments the Court considered the "total contract price" and stated that the total contract price should include the mortgages assumed. In its opinion, the Court said:

> "Now, giving to words their commonly accepted meaning, I have no doubt that the total contract price of the real estate involved here, within the meaning of the section quoted was $155,000.00. It is true that the $90,000.00 mortgage and the $2,000.00 mortgage which the purchaser agreed to pay were not paid to the seller. Nevertheless, the benefit flowing to the taxpayer from the payment of these mortgages by the purchaser was property, and just as much a part of the consideration as the cash which was paid as a part of the purchase price. * * *"

The decision was reversed by the Circuit Court of Appeals of the Sixth Circuit on March 6, 1931, 47 Fed. (2d) 1006, on another issue. The Circuit Court in its decision did not consider what was to be included in the "total con-

tract price", but only considered what was meant by "purchase price" and the "initial payments".

The Circuit Court of Appeals in the instant case disposes of the case of *Lucas* v. *Schneider* in the following language:

> "We cannot see that *Lucas* v. *Schneider*, (47 Fed. (2d) 1006 (C. C. A. 6)) has any bearing on the situation here. * * *" (R. 44.)

POINT III.

The payments made by the purchasers on the mortgages assumed by them to the mortgagees should be included as part of the "initial payments" and as part of the "installment payments actually received" as those terms are used in Section 212 (d) of the Revenue Act of 1926.

During the year 1924 the purchaser paid to the mortgagee on account of the mortgage assumed on the premises located at 82nd Street and Broadway the sum of $22,000.00 (R. par. 64, p. 29). This payment under respondent's theory represents a release of liability to the respondent under the bond and mortgage, and consequently becomes part of the initial payments as defined by Section 212 (d) of the Revenue Act of 1926.

During the tax year 1925 the purchaser paid to the mortgagees on account of the mortgages assumed on the premises located at 83rd Street and Broadway the sum of $22,500.00 (R. par. 66, p. 30). This constitutes part of the initial payments on the sale of the 83rd Street and Broadway property as defined by Section 212 (d) of the Revenue Act of 1926.

The receipt of this income occurs when the respondent is relieved by payment of his liability upon the mortgage assumed. This being so, the payments made by the purchaser to the mortgagee are taxable to the respondent in the proportion which the gross profit bears to the total contract price. This treatment of the payments on mortgages has been adopted both by the Commissioner and the United States Board of Tax Appeals in the case of *James M. Butler,* 19 B. T. A. 718. The Board in its opinion in that case stated (p. 728):

> "The petitioner in the instant proceeding operated under the cash receipts and disbursements basis, and the amount of $1,124.37 which he received at the time this lease was executed was income to him at the time received. However, the assumption, by the lessees, of an obligation to pay the remainder of $4,875.63 can not be considered income to the petitioner at the time of assumption. The petitioner was still liable under the mortgage and his liability was reduced only as payments were made on the principal of the mortgage by the lessees. But as such payments were made they did reduce petitioner's liability to the same extent and were income to petitioner when paid. In 1923 the lessees paid a total of $289.13 as principal accruing under the mortgage, and this will be included in petitioner's income for that year."

The Circuit Court of Appeals for the Sixth Circuit, in the *Schneider case,* 47 Fed. (2d) 1006, treated the assumption of the mortgage as the equivalent of cash, and offset the purchaser's primary obligation against the seller's secondary liability. The Court, in determining the effect in equity of the assumption of the mortgages by the purchasers, held that as between the seller and purchaser, under the laws of Kentucky, in which state this case arose,

it constituted the seller the surety and the purchaser the principal debtor to the mortgagee.

The law of New York seems the same as that of Kentucky with reference to the effect of an assumption of a mortgage. *Wadsworth* v. *Lyon*, 93 N. Y. 201; *Fairchild* v. *Lynch*, 99 N. Y. 359; *Wilcox* v. *Campbell*, 106 N. Y. 325; *Spencer* v. *Spencer*, 95 N. Y. 353; *M. Francis Wager, Res.*, v. *Thomas B. Link*, 150 N. Y. 549.

We feel the upper court was in error in treating the assumption of the mortgages as equivalent to cash. The assumption cannot be traded in. It has none of the semblance of cash. Who would buy it? It is only when the person assuming has performed by paying the mortgagee that the seller receives anything. The Finance Committee Report on page 6 hereof, and the prior regulations set forth in the Appendix, seem to confirm these conclusions. They clearly show an intention to tax cash and its equivalent in property when received.

The Circuit Court of Appeals of the Second Circuit apparently does not agree with the Court of the Sixth Circuit. See *Alfred M. Bedell* v. *Commissioner*, 30 Fed. (2d) 622; *Edith Andrews Logan* v. *Commissioner*, 42 Fed. (2d) 193.

Again in the instant case the Circuit Court of the Second Circuit has refused to recognize mortgages assumed as equivalent to property subject to tax.

Further, the Circuit Court of Appeals, Sixth Circuit, treated the mortgages assumed in two inconsistent ways. First, it held that the mortgage assumed was equivalent of cash; secondly, it held that it was a part of the initial payments only to the extent that it exceeded the basis of the seller. Thus this Court said in effect that part of the

mortgage assumed was "property other than evidences of indebtedness of the purchaser"* and part was not. This treatment, we believe, cannot be reconciled with the definition of initial payments as contained in Section 212 (d).

This inconsistency did not exist in Regulations 69 issued immediately after the passage of the Revenue Act of 1926. It was first injected by Treasury Decision 4255,** issued on January 8, 1929.

In the dissenting opinion in the *Schneider case* (C. C. A. 6), *supra*, Judge DENISON holds that the mortgage assumed is not property to the seller, but evidence of indebtedness.

The Circuit Court, in the case now before this Court, agrees with Judge DENISON. L. HAND, *J.*, in delivering the opinion of the Court, said:

> "* * * In any case Judge DENISON seems to us to have been right in saying that the assumption of a mortgage is not 'property' but 'evidence of indebtedness.' * * *"

The reason for the inconsistent treatment seems apparent. The Circuit Court of Appeals of the Sixth Circuit, the Board of Tax Appeals and the Commissioner all know that Congress intended to permit installment sales in real property; that in innumerable sales of realty mortgages are involved; and that if these were treated in their entirety as equivalent of cash, and part of the initial payments, the purpose of the statute would be defeated. This inconsistent position need not be followed to prevent the defeat of the statute. The construction urged by respondent overcomes the inconsistency and gives just results.

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*Excerpt from 212 (d) of Revenue Act of 1926.

**See footnote under Article 45, Regulations 69, in Appendix.

POINT IV.

The petitioner did not receive as income from the sale of the property in the year 1925 the excess of the mortgages assumed over the basis of the property to the petitioner, and such excess should not be reported as income in that year.

For the year 1925 the petitioner treated as income the amount of $77,967.00 on the theory that the mortgages assumed on the sale of the 83rd Street and Broadway property in 1925 exceeded the cost basis to the respondent by that amount. They did exceed the basis; but that fact does not create income. The respondent's right to report the profits from the sale of the properties on the installment plan being conceded, it follows that the excess of the mortgages assumed over the basis of the property sold in the year 1925 should not be reported as income in that year.

L. HAND, *J.*, in the Circuit Court opinion in this case, in discussing the excess of the assumed mortgages over the base, stated:

> "We can not see that Lucas *v.* Schneider (47 F. (2d) 1006 (C. C. A. 6)) has any bearing on the situation here. The ruling would indeed deprive the petitioner of any recourse to the section at all, which the commissioner does not assert. As applied to the sale in 1925, it would also require us to treat the excess of the assumed mortgages over the 'base' as 'property' received at once. But we could scarcely stop there; we should be obliged to treat the whole of the assumed mortgages in the same way, and that would suit neither party. In any case Judge DENISON seems to us to have been right in saying that the assumption of a mortgage is not 'property' but 'evidence of indebtedness.' * * *"

The item of $77,967.00, representing the excess of the mortgages assumed over the base, when added to the initial payments covering the sale of the property at 83rd Street and Broadway in the year 1925, results in an amount which is less than 25% of the total purchase price of $2,165,000.00. This fact distinguishes the instant case from the *Schneider* case. The petitioner asserts in his brief, pages 17 and 18:

> "* * * The excess of assumed mortgages over the 'basis' is properly treated as realized income to the taxpayer at the time of assumption of liability by the purchaser, for the taxpayer is then relieved of primary liability; and to the extent of such excess, theretofore received as a loan, the taxpayer has at that time derived income. See *United States* v. *Kirby Lumber Co.*, 284 U. S. 1."

The decision in the case of *United States* v. *Kirby Lumber Co., supra,* provides no support for the Commissioner's treatment of this item. In that case, the Supreme Court held "that where a corporation retires its own bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is taxable income for the taxable year." The retirement of an obligation is entirely different from the assumption of an obligation. In effect, the retirement of a bond obligation cancels it forever, while the assumption keeps the obligation alive; the obligor being relieved only when payments have actually been made thereon.

The petitioner in advancing his theory of the proper treatment of the excess of the assumed mortgages over the basis, cites in support the case of *United States* v. *Kirby Lumber Co., supra,* also the cases of *Clemmons* v. *Commissioner,* 54 Fed. (2d) 209 (C. C. A. 5); *Ford* v. *Commis-*

sioner, 51 Fed. (2d) 206 (C. C. A. 6), certiorari denied, 284 U. S. 666; *Board* v. *Commissioner,* 51 Fed. (2d) 73 (C. C. A. 6), certiorari denied, 284 U. S. 658; *Commissioner* v. *Moir,* 45 Fed. (2d) 356 (C. C. A. 7).

These cases support the statement of the petitioner that the receipt of income is not deferred for purposes of taxation beyond the year in which received because there exists some potential liability of which a loss may be sustained. But these cases do not affect the instant case as they relate to the actual receipt of cash in the taxable year. In the instant case the respondent has not actually received cash as the result of the assumption of the mortgages. Further, the transactions involved in the instant case relate to the reporting of profit on the installment plan, which method was not involved in the cases cited by the petitioner.

The respondent, as an alternative to its contention that the "total contract price" includes the mortgages assumed by the purchaser, urges that, in the event that this Court holds that the definition of the Commissioner as to "total contract price" is correct, nevertheless, the item of $77,976.00 is not a separate item in the year of sale, but should be included as part of the total profit, namely, $642,967.00, and this profit should be reported over the period during which the smaller amount of $565,000.00 will be received. It is the respondent's theory that if the statute be construed as to exclude mortgages assumed from the "total contract price", then Congress intended to permit the taxpayer to treat the cash payments received from the purchaser as income in each year of their receipt; this being so, even though as in the respondent's case the income would be in excess of 113-plus per cent. in each year of their receipt. This difficulty was never expected by Congress in enacting Section

212 (d) as in no case would the profit exceed 100 per cent. if the "total contract price" included the mortgages assumed. It is the petitioner's theory that the statute limits the reporting of profit under the installment method to a percentage of 100 per cent. This theory would always be correct if the "total contract price" included the mortgages assumed. But if the petitioner's theory that the "total contract price" does not include the mortgages assumed is correct, then there is no foundation for the theory that the statute limits the reporting of profit to a percentage of 100 per cent. If the petitioner is correct in his theory, then Congress certainly failed to enact the statute which it originally intended to enact. If the basis which is the amount allocable as the cost of the equity, namely, $565,000.00, is the only amount that can be used in determining profit, then it seems clear that the amount of $77,967.00, which is now in dispute, would be non-taxable in the year of sale. It would only be taxable over the period in which the seller was relieved of liability on the mortgages assumed. Either construction of the statute would result in the omission or exclusion of the amount of $77,967.00 from the income to be reported in the tax year 1925.

Conclusion.

The decision below is correct and should be upheld.

Respectfully submitted,

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APPENDIX.

Salient Portions of Regulations Covering Installment Sales Issued by the Commis.

EXCERPTS FROM REGULATIONS 69 ISSUED UNDER THE REVENUE ACT OF 1926.

Art. 42. Sale of personal property on installment plan.—

* * * The rule prescribed is that a person who regularly sells or otherwise disposes of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, **may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total or gross profit** (that is, sales less cost of goods sold) **realized or to be realized when the property is paid for, bears to the total contract price.** (See section 212 (d).) Thus the income of a dealer in personal property on the installment plan may be ascertained by taking as income that proportion of the **total payments received** in the taxable year from installment sales (such payments being allocated to the year against the sales of which they apply), which the total or gross profit realized or to be realized on the total installment sales made during each year bears to the total contract price of all such sales made during that respective year. * * *

Art. 44. Sale of real property involving deferred payments.—Under section 212 (d) deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed one-fourth of the purchase price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed one-fourth of the purchase price.

Sales falling within class (1) and class (2) alike include (a) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the purchase price has been paid, and (b) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

*In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall not be considered as a part of the "initial payments" or of the "total contract price", but shall be included as part of the "purchase price", as those terms are used in section 212 (d), in articles 42 and 45, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the "initial payments", the "total contract price", or the "purchase price".

Art. 45. Sale of real property on installment plan.—In transactions included in class (1) in article 44, **the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price.**

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property, the entire amount received on installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property while in the hands of the purchaser, will be income of the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the installment sale.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

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*The last paragraph of Article 44 of Regulations 69 was amended to include the following, by Treasury Decision 4255, VIII—1 Cumulative Bulletin, page 165, approved January 8, 1929:

In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the "purchase price", but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as a part of the "initial payments" or of the "total contract price", as those terms are used in section 212 (d), articles 42 and 45, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount

sioner of Internal Revenue Under the Revenue Acts of 1924 and 1926

EXCERPTS FROM REGULATIONS 65 ISSUED UNDER THE REVENUE ACT OF 1924.[4]

Art. 42. Sale of personal property on installment plan.—* * *

The rule prescribed is that in the sale or contract for sale of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, **the income to be returned by the vendor will be that proportion of each installment payment which the gross profit to be realized when the property is paid for bears to the gross contract price. Such income may be ascertained by taking as profit that proportion of the total cash collections received in the taxable year from installment** sales (such collections being allocated to the year against the sales of which they apply), which the annual gross profit to be realized on the total installment sales made during each year bears to the gross contract price of all such sales made during that respective year. * * *

Art. 44. Sale of real estate involving deferred payments.—Deferred-payment sales of real estate ordinarily fall into two classes when considered with respect to the terms of sale, as follows:

(1) Installment transactions, in which the initial payment is relatively small (generally less than one-fourth of the purchase price) and the deferred payments usually numerous and of small amount. They include (a) sales where there is immediate transfer of title when a small initial payment is made, the seller being protected by a mortgage or other lien as to deferred payments, and (b) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the agreed installments have been paid.

(2) Deferred-payment sales not on the installment plan, in which there is a substantial initial payment (ordinarily not less than one-fourth of the purchase price), deferred payments being secured by a mortgage or other lien. Such sales are distinguished from sales on the installment plan by the substantial character of the initial payment and also usually by a relatively small number of deferred payments.

In determining how these classes shall be treated in levying the income tax, **the question in each case is whether the income to be reported for taxation shall be based only on amounts actually received in a taxing year,** or on the entire consideration made up in part of agreements to pay in the future.

Art. 45. Sale of real estate on installment plan.—In the two kinds of transactions included in class (1) in the foregoing article, **installment obligations assumed by the buyer are not ordinarily to be regarded as having a fair market value, and the vendor may report as his income from such transactions in any year that proportion of each payment actually received in that year which the gross profit to be realized when the property is paid for bears to the gross contract price.** If the return is made on this basis and the vendor repossesses the property after default by the buyer, retaining the previous payments, the entire amount of such payments, less the profit previously returned, will be income to the vendor and will be so returned for the year in which the property was repossessed, and the property repossesed must be included in the inventory at its original cost to himself (less any depreciation as defined in articles 161 and 162). If the taxpayer chooses as a matter of settled practice consistently followed to treat the obligations of the purchaser as having a fair market value and to report the profit derived from the entire consideration, cash and deferred payments, as income for the year when the sale is made, this is permissible. If so treated, the rule prescribed in article 46 will apply.

[4]Articles 42, 44 and 45 were substantially the same in Regulations 45 and 62 of the Revenue Acts of 1918 and 1921, respectively.

ILLUSTRATIVE JOURNAL ENTRIES FOR RECORDING PROFITS ON THE INSTALLMENT PLAN

(1)	Due from Purchaser	$2,100,000.00	
	To Sale of Property		$2,100,000.00
	(82nd Street and Broadway)		
	To record the purchase of 82nd Street and Broadway property by vendee for a contract price of $2,100,000.00; payable $300,000.00 in cash, purchase money mortgage of $700,000.00 and assumption of $1,100,000.00 first mortgage. See detail of installment payments, etc.		
(2)	Sales of Property (82nd Street and Broadway)	$ 558,676.52	
	To Deferred Profit on Sale		558,676.52
	To transfer excess of sales price over cost to unrealized profit on sale of 82nd Street and Broadway property, reported on installment plan.		
(3)	First Mortgage Payable	$ 22,000.00	
	To Due from Purchaser		22,000.00
	To record the installment due December 1, 1924 and paid on first mortgage direct to mortgagee by purchaser.		
(4)	Deferred Profit on Sale of 82nd Street and Broadway	$ 93,644.83	
	To Realized Profit on Sale		93,644.83
	To record the profit applicable to year 1924 on sale of 82nd Street and Broadway property, reported on installment plan as follows:		
	Cash received on Sale..... $300,000.00		
	Installment received on purchase money mortgage.. 30,000.00		
	Installment on first mortgage paid in 1924 by purchaser to mortgagee.... 22,000.00		
	TOTAL $352,000.00		

Percentage of profit=.26603644 x 352,000.00=93,644.83

SUPREME COURT OF THE UNITED STATES.

No. 475.—October Term, 1932.

David Burnet, Commissioner of Internal Revenue, Petitioner, *vs.* S. & L. Building Corporation.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[March 13, 1933.]

Mr. Justice McReynolds delivered the opinion of the Court.

The respondent, Building Corporation, sought redetermination of deficiency income taxes for 1924 and 1925. The Board of Tax Appeals sustained the Commissioner's final action of June 17, 1930; the court below reversed its judgment. The point now in controversy has relation to the distribution for taxation of income derived from sales on the installment plan of two pieces of real estate on 82nd and 83rd Streets, New York City. Each was covered by one or more mortgages which the purchaser assumed.

The Revenue Act 1926, c. 27, 44 Stat. 9, 23, 39, 41, Sec. 230, lays a tax upon the net income of corporations. Section 232 provides—"In the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226.

"Sec. 212 (d) The net income shall be computed . . . in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but . . . if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. . . .

"(d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the in-

stallment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term 'initial payments' means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made."

"Sec. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provisions of . . . the Revenue Act of 1924, . . ."

Treasury Regulations 69, Article 44, promulgated August 28, 1926—as amended in 1929:—

"Art. 44. Sale of real property involving deferred payments.—Under section 212 (d) deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows: (1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed one-fourth of the purchase price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed one-fourth of the purchase price.

Sales falling within class (1) and class (2) alike include (a) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the purchase price has been paid, and (b) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the 'purchase price,' but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as a part of the 'initial payments' or of the 'total contract price,' as those terms are used in section 212 (d), in articles 42 and 45, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the 'initial payments,' the 'total contract price,' or the 'purchase price.'

"Art. 45. Sale of real property on installment plan.—In transactions included in class (1) in article 44, the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price."

In 1924 respondent sold the 82nd Street property then under mortgage which it had executed to secure a loan of $1,100,000, payable in semi-annual installments of $22,000 until 1933 when the balance would become due. The purchaser assumed the mortgage; paid $300,000 in cash; agreed to pay $700,000 and secured this by a purchase money mortgage. Upon the latter mortgage $30,000 was paid in 1924 and $36,250 in 1925. In 1924 and 1925, respectively, the purchaser paid upon the assumed mortgage $22,000 and $24,000.

The Commissioner estimated the depreciated cost of the property at $1,541,323.48. Subtracting this from the total sale price, $2,100,000, he ascertained realized profit—$558,676.52.

He ruled that for 1924 the taxable sum was the same proportion of the amount actually received during the year ($330,000) as the entire profit ($558,676.52) was of the total ($1,000,000) payable directly to the taxpayer—55% plus. He excluded the assumed mortgage from the total used for determining the applicable percentage and held "total contract price" was what the purchaser agreed to pay directly to the vendor—the whole amount which the taxpayer expected to receive in money.

Payments received by respondent during 1925 were likewise assessed.

In 1925 respondent sold the 83rd Street property then subject to two mortgages which it had executed to secure loans of $1,100,000 and $500,000 respectively, payable in installments—six and three months—until 1933 and 1934 when the balance would become due. The purchaser assumed both mortgages; paid $300,000 in cash; and agreed to pay $265,000 and secured this by a purchase money mortgage. On the latter obligation $2,000 was paid in 1925. During 1925 the purchaser paid on the assumed second mortgage $22,500.

The Commissioner fixed the depreciated cost of the property at $1,522,035. Subtracting this from the total sale price, $2,165,000, he found the realized profit—$642,967. He ruled that the difference ($77,967) between the base, or depreciated cost, ($1,522,033) and the total of the assumed mortgages ($1,600,000) should be treated as if received in money by the taxpayer during 1925; also, that the sum subject to taxation in 1925 was the same proportion of what the taxpayer received, actually and constructively, during the year ($302,000 plus $77,967) as the realized profit ($642,967) was of the total amount ($565,000) which the purchaser agreed to pay directly to the taxpayer—100% plus.

He excluded the amount of the assumed mortgages from the totals used to determine the applicable percentage and payments on them were not regarded as received by the vendor. He also treated as if cash received by the vendor in 1925 the difference between the depreciated cost and the total of the assumed mortgages. "Total contract price" was held to be the total amount payable directly to the vendor.

The respondent maintains that the assumed mortgages should be regarded as part of the contract price and payments upon them by the purchaser should be treated as money received by the vendor. In this way it is said the tax would be spread over the entire life of the assumed mortgage. And it further insists that the excess of the assumed mortgages over the depreciated value of the 83rd Street property should not be regarded as if money actually received by the vendor during 1925.

Respondent's books were kept upon the accrual basis; but all agree that in the circumstances the Revenue Act of 1926 permitted

assessments upon the installment basis. The Commissioner undertook to act according to his prescribed regulations.

Prior to the Act of 1926 the Revenue Acts definitely recognized only two bases for tax returns—cash and accrual. Where sales were upon the installment plan application of either of these bases led to hardship; payment of the total tax on ascertained profit was often required in a single year. By regulations the Commissioner offered some alleviation; the vendor was allowed to distribute the profit through the years during which purchase money was actually received. The general principal underlying these regulations was to make division of partial payments and apply part as return of capital and part to profit. In 1926 the Board of Tax Appeals disapproved of the earlier regulations and pointed out that the statutes permitted returns only upon the cash or accrual basis. Thereupon, Congress enacted Section 212 (d), above quoted. The end in view was to permit the Commissioner to make assessments according to the general principle theretofore followed under regulations deemed appropriate to the varying situations. The new plan was optional; taxpayers were allowed to elect whether to make returns under the regulations upon the new basis or upon one of the old bases.

The Conference Report to the House, on Revenue Act of 1926, p. 32, House Reports, Volume I, 69th Congress, 1st Session, 1925-1926, declares concerning Section 212 (d):—"This amendment writes into the bill the basic principles of the installment method authorized by prior regulations". See Report Senate Committee on Finance, No. 52, 69th Congress.

Installment sales of real estate encumbered by liens give rise to many complications which Congress could not readily foresee. Accordingly, it entrusted to the Commissioner wide discretion in respect of details. And considering the practical requirements of the taxing system, we think the regulations now challenged constitute a fair attempt to effectuate the legislative intent. They are within the broad discretion granted to the Commissioner and violate no definite provision of the statute.

The amounts which respondent realized as profits are not in question. These were subject to taxation either upon the accrual basis or at the taxpayer's option on the installment basis. Generally, the Commissioner's regulations permitted the tax payments to be spread over the period during which the taxpayer would re-

ceive funds and divided these partly into return of capital and partly into profits actually collected. The method suggested by the respondent would inevitably lead to many practical difficulties, might postpone collection far beyond the time when the vendor would receive any direct payments; and probably would render impossible determination from the taxpayer's books of what he should account for.

The Commissioner's treatment of the excess of the mortgages on the 83rd Street property over the base cost followed the general purpose to place reasonable limitation upon the spread of the tax. It was appropriate in the unusual circumstances presented—certainly not prohibited. It was a practical way to accomplish the end. Some possible departure from the method prescribed for ordinary circumstances is not enough to destroy what he deemed necessary to meet unusual conditions.

The excess of $77,967 under the sale agreement would never actually come into the vendor's hands but it represented part of the admitted profits and was subject to taxation. No positive provision in the statute required that it be spread over subsequent years and we think there was nothing illegal or oppressive in treating this as if an actual payment. The taxpayer has been treated more leniently than if required to report upon the accrual basis. The Regulations were not contrary to any positive provisions of the statute and, as said by the Board of Tax Appeals, were "both equitably and legally sound."

Since 1926, the Board has consistently upheld the Commissioner's regulations as to profits on installment sales. *Frank J. Bosshardt*, 4 B. T. A. 1262; *Dalriada Realty Co., Inc.*, 5 B. T. A. 905; *Pacheco Creek Orchard Co.*, 12 B. T. A. 329; *Katherine H. Watson*, 20 B. T. A. 270; *Fifty-three West Seventy-second Street, Inc.*, 23 B. T. A. 164; *Metropolitan Properties Corporation*, 24 B. T. A. 220. And the Revenue Acts of 1928 and 1932 substantially reenacted the pertinent provision of the Act of 1926.

The Commissioner and Board of Tax Appeals have practical knowledge of the intricate details incident to tax problems and their determination in circumstances like those under consideration here should be given effect when not clearly contrary to the will of Congress.

Reversed.